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In the

Supreme Court of the United States

October Term, 1919.

No. 593.

CHARLES E. SMITH, *Appellant,*

vs.

KANSAS CITY TITLE & TRUST COMPANY ET AL., *Appellees.*

APPELLANT'S BRIEF.

STATEMENT.

1. THE GENERAL NATURE OF THE CASE.

This in an appeal (Rec. 3) from a decree (Rec. 30) below dismissing a bill (Rec. 1-19) filed to test the constitutionality of the various provisions of the Federal Farm Loan Act of July 17, 1916, as amended on January 18, 1918 (8 Fed. Stat. Ann. Supp. 1918, pp. 14-42; 39 Stats. L. 360; 40

Stat. L. 431.) The United States (Rec. 30, 31, 34) and the Federal Land Bank of Wichita, Kansas (Rec. 20, 30, 31, 34), and the First Joint Stock Land Bank of Chicago, Illinois (Rec. 19, 30, 31, 34), representing the *two* classes of banks named in the Act, all *voluntarily* became parties, took practical charge of the defense (Rec. 31) and are now here as appellees, seeking to obtain a speedy decision *on the merits* of *all* questions raised as to the validity of said Act and its tax exemption features.

2. THE PROCEEDINGS BELOW AND THE APPEAL.

Appellant, plaintiff below, is a large stockholder in the appellee, defendant below, which is a corporation organized as a trust company under the laws of Missouri (Revised Statutes Missouri 1909, Chap. 12, Arts. I, II and III; Laws of Missouri, 1915, pp. 103-127, amending same; sec. 127, subd. 11, p. 167; Laws Mo. 1915, pp. 165-167), providing:

> "Corporations may be created * * * for any one or more of the following purposes: * * * 11. To buy, invest in and sell all kinds of government, state, municipal and other bonds, and all kinds of negotiable and non-negotiable paper, stocks or other investment securities."

A trust company is thereby authorized to *invest* its corporate and trust funds in such bonds as, in the eyes of the law, are *real* legal "investments,"

as distinguished from those which are unauthorized and pretended. The statutory power to deal in bonds is only "to buy, invest in and sell all kinds of government, state, municipal and *other* bonds and all kinds of negotiable and nonnegotiable paper, stocks or *other* investment securities." These last words necessarily imply that any outlay of funds for securities which are not "investments" is illegal, unauthorized and *ultra vires*. So it was held by Circuit Judge Thayer in *Bierce* v. *Guardian Trust Company*, in an unreported opinion, a copy of which is attached (*Infra*, p. 81) as Part 1 of the Appendix hereto. Investments within this view do not include bonds or stocks of any corporation which are of a speculative or other doubtful nature (17 A. & E. Enc. L., 2d Ed., 438, 440, 443, 444; *Lamar* v. *Micou*, 112 U. S. 452), and cannot be made in *illegal* bonds issued by an *illegal* organization under an unconstitutional statute (id.) because (*Norton* v. *Shelby Co.*, 118 U. S. 425) "an unconstitutional act is not a law, it confers no rights, it imposes no duties, it affords no protection, it creates no office; it is in legal contemplation as inoperative as though it had never been passed."

If a corporate fiduciary, as defendant is, wished to make an investment in securities of such character, it might have absolutely protected itself by applying to and obtaining from a court specific directions in the premises, the courts "having large powers of supervision over the investment of funds held by fiduciaries" (id. 431). If appellee would not, in this way, even ask any relief, manifestly a good faith protesting stockholder can, in the

absence of its *voluntary* action, have an injunction against a proposed improper and illegal venture. Such was the theory of the bill. The course of this case shows, and all interested therein, including appellees' eminent counsel, now concede the propriety thereof. In its most simplified form, the case presented was one where the directors of the corporate defendant, over the objections and protests of the stockholding plaintiff, proposed and threatened to *invest* its corporate and trust funds in bonds issued under the Farm Loan Act, *not only* by the Federal Land Banks, but *also* by the Joint Stock Land Banks. Thereupon plaintiff filed his bill (Rec. 1-18) to enjoin as illegal and *ultra vires* each proposed and threatened action. The claim was that the act (8 Fed. Stat. Ann. Supp. 1918, pp. 14-42; 39 Stat. L. 360; 40 Stat. L. 431), and the tax exemption (secs. 21, 26) features thereof were unconstitutional and, hence, the bonds of *neither* bank were *real* "investments." The case grew into one of great proportions and of national importance. The government, as well as each of the defendant banks, recognized that *all* questions as to the validity of the act authorizing the bonds and all tax exemption features thereof were thereby fairly and satisfactorily presented. They *voluntarily* came into the case, assumed charge of the defense, presented, *on the merits,* the sole constitutional question involved and convinced the court below that it should uphold (Opinion, Rec. 22-30) the Act. The bill, so as to more fully present the case, was, *at the suggestion of the Government and these banks,* in certain unnecessary respects,

amended (Rec. 34) by interlineation. Thereupon defendant filed a motion to dismiss (Rec. 31) because, *as thus amended,* it did not state facts sufficient to constitute a cause of action. The United States appeared (Rec. 30, 31, 33, 34) *amicus curiae*. Both banks, agencies established by the Act, upon their intervention (Rec. 19, 20, 30, 31, 34), became parties defendant. They and the United States were permitted (Rec. 31) to and did "adopt as their own and were heard upon the motion to dismiss." This motion was sustained and a decree (Rec. 30, 31) entered dismissing the cause. Thereupon an appeal (Rec. 31) was allowed, the case brought here (Rec. 32-36), where all formalities were waived. Upon stipulation (Rec. 33, 34) it was advanced and is now here for final presentation.

3. QUESTIONS INVOLVED ARE THE VALIDITY OF THE FARM LOAN ACT AND ITS TAX EXEMPTION FEATURES.

The sole questions involved are whether that which, by its terms, is designated as the Farm Loan Act (39 Stat. L. 360; 40 Stat. L. 431), establishing *each* class of banks, and its sweeping tax exemption features (secs. 21, 26) are violative of some express or implied provision of the Constitution.

4. GENESIS OF THE ACT.

In 1913, a three months' European summer trip, commonly called a junket, was taken by a United

States commission composed of Congressmen of one political faith, and by a number of delegates appointed by the Southern Commercial Congress, a voluntary convention or association of citizens. (64th Congress, Senate Document 500, p. 29.) The latter was headed by one David Lubin, who was described as a "delegate of the United States International Institute of Agriculture, Rome, Italy," whatever that may mean. In a speech before the Commission, Mr. Lubin (63d Congress, 1st Session, Sen. Doc. 114, p. 4) declared that the members thereof and the delegates were "at the feet of the German people to learn." A propaganda was afterwards started in Congress for the establishment in this country of a system of *rural* credits, based upon the German plan of collective and co-operative borrowing and lending of money on long-time farm mortgages. The words "German plan" are used advisedly. Such plan was first adopted in Prussia. It found its principal development in Germany. Some modifications thereof have, however, been adopted and are in operation in other parts of Europe. It is quite significant that the plan is German, as the real question here is whether there has been enacted a law inimical to the spirit of our institutions and contrary to the provisions of our Constitution. The commissions, confessedly, studied only European (not American) conditions and obtained a large amount of data about foreign methods. They came home enthusiastic about the German land mortgage scheme. Then followed extended public addresses, reports and discussions (63d Cong. 1st Sess. Sen. Docs. 17 and 214; 2nd

Sess. Sen. Docs. 261 and 380; 64th Cong. 1st Sess. House Doc. 494; House Rep. 630; Sen. Doc. 472; 64th Cong. 1st Sess. Sen. Doc. 9; 63d Cong. 1st Sess. Sen. Doc. 114; same Sess. hearings on Rural Credits before House Sub. Com. of Com. on Banking and Currency and Joint Hearings on Rural Credits, before Subcommittees of Senate and House Committees on Banking and Currency). The most prominent characteristic thereof was the constant citation of German methods as an argument for our adoption of something of the same kind. A fair sample is found in an address (63d Cong. 1st Sess. Sen. Doc. 9, p. 21) of Senator Sheppard, of Texas before the Texas Farmers' Congress on Aug. 3, 1915, devoted to a glorification of German methods, a plea for their imitation here, and an argument that the nearer the American people approach the German system, "the more successful we will be." Merely because the system is German does not *necessarily* imply that it is illegal. There may or may not be some excellencies in all or any of the various European plans. Such plans may be adaptable to foreign conditions, where class discriminations may be made and the right of local authorities to tax local property may be denied. The real inquiry is whether they can be adopted here, where totally different conditions prevail and constitutional limitations exist. The Act was approved (39 Stat. L. 360) July 17, 1916. This, however, was *before the war*. Hence, no exercise of a war power is involved, and any such thought may be dismissed. The nearest the war got to the scheme was that the government, under the amend-

ment of January 18, 1918 (40 Stat. L. 431), *temporarily* loaned for its support, money presumably extracted from the people for war purposes. The purpose of the Act was, not to have performed any governmental function, but solely to give, by *private* means, the farm owners, *as distinguished from all others,* money upon "easy terms," or, as put by the then Secretary of the Treasury Mr. McAdoo, "*long*-term mortgages at *low* rates of interest," with a provision for repayment of the principal in annual installments, "so that the small *farmer,*" to the exclusion of all others, could borrow and pay off both principal and interest "through annual installments which will be less than the straight interest charges he has been paying on his mortgages under the old system." To find a ready market for these loans, wholly *private* in their nature, they and all the *private* capital invested therein were attempted to be wholly withdrawn from *all* state and federal taxation. The organizations charged with the execution of the Act were merely commission agents, and in an attempt to accomplish the desired result, were glibly miscalled banks and "instrumentalities of the government." As this case presents the question whether, under our system of government, the law is valid, there must be herein a determination, *not* of what the act or the agencies (Federal Land Banks or Joint Stock Land Banks) appointed to carry it out are called, *but what they really are.* Put in still more concise form, the real question, regardless of the use of mere words, is whether the *main* purpose of their establishment was to have exercised the

governmental power of the nation, as distinguished from those respecting *private and proprietary* rights, which, however owned, arise solely out of and adhere in the ownership and control of *private* property.

5. PASSAGE AND THEORY OF THE ACT.

(a) The advocates of the scheme and their adherents had framed and passed the Farm Loan Act. It was based upon the seeming thought that although the 10th Amendment to the Constitution reserved to the states all the powers not granted to the United States (and none were so granted as to a Farm Loan Act), yet since *general* banking was a *governmental* function, there was *implied* the power to establish such agencies, calling them Federal Land Banks and Joint Stock Land Banks, just as had been *implied* the power to establish national banks.

(b) The lawmakers evidently overlooked the thought which prompts this appeal, that it was not permissible for them (*First National Bank* v. *Union Trust Co.*, 244 U. S. 416) to organize an institution not "of a *governmental*," but *mainly*, if not entirely, "of a *private* character," ignore the difference between or the scope and character of "*governmental*" and "*private* powers," and treat the latter as a wholly immaterial consideration. Anyhow, agencies were provided, the *main* purpose of which was to exercise merely *private* powers. They were called banks and "instrumentalities of the government," though nothing could have been further from the fact.

(c) Anyhow, there was passed the Act, the validity of which is now challenged.

6. SUBSTANCE OF THE ACT.

The Act outlines a scheme of creating for borrowers and lenders *private* corporate borrowing and lending agencies. These agencies were not to do any *general* banking business (that being expressly forbidden), but their energies were to be *exclusively* confined to lending on farm mortgages, first, $10,000 or less to actual *cultivators* of the soil with which to buy or improve the land, and, second, *unlimited* sums to *any* person for *any* purpose whatsoever. In its most concise form the scheme created and classified the agencies into corporations *named* National Farm Loan Associations, herein called Farm Associations, Federal Land Banks, herein called Land Banks, and Joint Stock Land Banks, herein called Joint Stock Banks. The *alleged* banks are, however, only such in *name*. They can do no banking business. They are of two distinct kinds, the nature of which call for *separate* consideration.

(1) Land Banks.

(a) Each of any ten or more *cultivators* and owners of *farm* land may mortgage same for not more than $10,000, but only to buy or improve it. They must, however, *first* form a corporation known as a Farm Association. This corporation, made up exclusively of borrowers, acts just like a

broker or commission agent ordinarily does, as a borrowers' agency. In addition, it endorses the paper of each borrower, thus, in a way, putting all borrowers behind the obligation. Each borrower subscribes and pays for his stock in a sum equaling five per cent of the loan. This sum is added to and made part of the mortgage. The Farm Association must, however, apply to and obtain the money from a Land Bank, and, as a condition of so doing, must take and pay for the bank's stock in a sum also equal to five per cent of the loan.

(b) The *first* money loaned the borrowing farmers was, in the main. obtained from the government by it subscribing and paying for about $750,000 of each Land Bank's stock. While the government did so take the stock, it could receive no dividends thereon. Each transaction by it was, therefore, practically a government loan without interest. The Farm Association, as business justifies it, must take over this government Land Bank stock with the money paid in by future borrowers in payment of their stock subscriptions.

(c) The Land Bank, having acquired the farm mortgage loans, can raise *new* money for like *future* investment by selling its collateral trust bonds secured thereby. This is the extent of its office.

(d) When the Farm Association has taken up the government's *temporary* loan, held in the form of Land Bank stock, the government's interest in the scheme entirely ceases. The borrowers then become sole owners and step into absolute control of the bank or borrowing agency.

(2) Joint Stock Banks.

The government can never have any interest in, but individuals *only* can organize, own and control Joint Stock Banks. These *alleged* banks can loan to *any one* on *farm* lands, in *unlimited* amounts, and without any restrictions as to the use to be made of the money. Such a bank can, without restriction, issue and sell its collateral trust bonds with its mortgages as security.

(3) Exemption from taxation.

To induce investors to continue to furnish the money for the Land Bank business, or even *start* into that of the Joint Stock Bank, a *huge* price is paid, if tax exemption can be considered a "price," as it actually is. The securities are entirely withdrawn from the domain of the states and ar bitrarily made exempt from any kind of taxation, state or federal. This is done by simply, but falsely, *calling* them "instrumentalities of the Government." This plain method of depriving a state of its revenue, if carried far enough, can destroy any local government by taking from it the means by which it is supported.

(4) Attempted justification of the arrangement.

By treating the scheme as one to do a *general* banking business, which each of such agencies is expressly prohibited from doing, it is sought to justify its adoption as an exercise of an implied *governmental* power. The *real* question, then, is

whether by the use of *mere words* this can be done, when the *real* fact is that the *main* purpose of these corporate agencies is *not* to do any banking business and *not* to perform any *governmental* function, as distinguished from one which is strictly *private*. If the *main* purpose is to use the system for *private* and *proprietary* purposes, and any governmental function is to be exercised only as an incident thereto, or as a cloak to disguise the *real* purpose, then the power to pass the Act cannot be implied.

7. MISLEADING AND DECEPTIVE TITLE.

The title to the Act is:

> An act to *provide for agricultural development,* to create a standard form of investment based upon farm mortgages, to equalize rates of interest upon farm loans, to *furnish a market for United States bonds, to create government depositaries and financial agents for the United States and for other purposes.*"

None of the italicized words has, however, the slightest relation to anything appearing in the body of the Act. Tested by its provisions, the title should have been limited "to creating a form and method of borrowing on an investment in *farm* mortgages, and exempting same from *any kind* of taxation, state or federal." The Act should, at most, as its terms state (sec. 1), have been called a "Farm Loan Act," leaving to imagination the subjects with which it dealt. A close

analysis, at the expense of some tediousness, must be made of *all* its terms so as to avoid being, in any wise, misled by the title. At the same time, such an analysis will better enable one to clearly determine whether a foreign, un-American scheme has been adopted which not only destroys the substantial rights of the states, but also wholly fails to accord with the spirit of our institutions. as outlined in the express provisions of the constitution. In making the analysis, there must be kept clearly in mind the apparent distinction recognized below (Rec. 27, 30), but not there enforced, between the *different* things to be done by the *so-called* Land Banks and by those *called* Joint Stock Banks. The latter (sec. 16) have not even a *pretended* substantial connection with the government and perform no real office for it. Hence, there is not the slightest excuse for calling (sec. 26) loans made to or bonds issued by them "instrumentalities of the Government," even if one could fairly so call them when the loans were made to or bonds issued by Land Banks.

It will tend to clearness to constantly keep in mind the *separate* and *distinct* part of the legislative scheme which is played by each class of these agencies or alleged banks. This can best be done by (a) first considering the Act as if it created (as it was *originally* designed), the Land Banks as the *sole* agencies through which the money to loan small farmers was to be obtained from the investing public and then (b) following these considerations with a concise but *separate* statement of the few words, evidently inserted as

a pure afterthought, which provide for the Joint Stock Banks, which were created, in the interest of large, tax-dodging investors, and became *additional* like agencies to afford a device for such investors lending *unlimited* quantities of *tax-free* money.

8. ANALYSIS OF THE ACT SO FAR AS IT CONCERNS LAND BANKS.

The real scheme was, so far as concerned *small* cultivating farmers, to dispense with all services for borrower and lender by the ordinary broker or go-between and substitute therefor a plan with corporate *agencies,* whereby (a) these *farmers* could, through one of the agencies, borrow *cheap* money on *long-time* first mortgage farm loans, and (b) the funds to be loaned them raised by another agency, organized for that *sole* purpose, upon collateral trust bonds secured by the mortgages.

When closely analyzed, omitting the details of the various provisions creating and defining duties to be performed by a horde of office holders, the Act as amended, so far as it relates to Land Banks, will be found to be this:

(1) Title of Act and its administration.

The vice of the real title is recognized and a short, undefined one, Farm Loan Act, is substituted. The administration of the Act is placed under the direction and control of the Federal Farm Loan Board, herein called the Board (sec. 1).

(2) Definitions.

First *farm* mortgages and *farm* loan bonds are made a class of themselves, and are defined to be (a) *such* mortgages on *farm* lands as are approved by the Board, and (b) such collateral trust bank bonds as are secured by such mortgages deposited as collateral with an appointee named as a Farm Loan Registrar, herein called the Registrar (secs. 2, 3).

(3) The Board.

The Board is made a bureau of the Treasury Department. It consists of five members, including the Secretary of the Treasury. The other four members are appointed by the President and confirmed by the Senate. One of the four must be named as Farm Loan Commissioner. He acts as the executive officer (sec. 3) of the bureau.

(4) Land Banks.

(a) The raising of money from investors, so as to make *farm* loans to *farmers,* was the first essential of any possible plan, for it is manifest that if there was not provided money to loan, the whole scheme would fail. In lieu of obtaining an absolute donation from the government or calling, as in the ordinary case, for the ordinary brokers' services with private investors, corporate agencies were created for the purpose of acting as the necessary go-betweens to reach those expected to borrow and those expected to furnish the funds to be loaned. These agencies, omitting for the

present any reference to Joint Stock Banks, are *in name* called Land Banks, though they perform no function of and bear no resemblance to real banks. They are created by the Board, which divides continental United States, excluding Alaska, into twelve districts, in each of which it establishes such an *alleged* bank as a federal corporation. On the filing of an "organization certificate," the corporation is created (sec. 4). The Board appoints five directors to *temporarily* manage it. This temporary management ceases and the *permanent* directors take charge (secs. 4 and 32 as amended) whenever, first, the Farm Association, another agency (but strictly a borrower's), hereinafter described, has subscribed $100,000, second, any Land Bank stock subscribed by such associations equals that held by the government (40 Stat. L. 431), and third, the agency or alleged bank has retired all its bonds, if any, purchased from it by the government under the amendment of January 18, 1918.

(b) Each of such Land Banks, before beginning business, must have a subscribed minimum capital of $750,000. The capital is divided into five-dollar shares. The government or any one else may subscribe therefor. As an assurance of money with which to *start* in the loan business, the Secretary of the Treasury must, for the government, if, within thirty days after the stock subscription books are opened, any part of such minimum capital remains unsubscribed, subscribe therefor. The same is to be paid out of any unappropriated money. This, in the first instance,

for the twelve agencies or *alleged* banks, was an assurance that there would be at least $9,000,000 to loan. This was to be, in effect, a *temporary* government loan, without interest, for this government stock must be subsequently retired by the Farm Associations through loans subsequently made. The government receives no dividends, though on all *other* stock they are paid, if and when earned. After its *temporary* subscription is retired, bank stock only can be issued in connection with mortgage loans, i. e., upon every loan the borrower takes Farm Association stock in a sum equaling five per cent of the loan. The latter, in presenting to the Land Bank an application for a loan, must itself subscribe for stock of the bank for a similar amount. The government and any Farm Association is entitled to one vote for each share of stock owned by it. No *other* shareholder can, however, vote (sec. 5). The effect is that each Land Bank is formed as, and ultimately is to become, a borrowers' agency and will receive all of the profits thereof.

(5) Powers of Land Banks.

(a) Upon the approval of the Board, each agency or Land Bank can, through a Farm Association, or certain of its agents, but not otherwise, make farm loans and issue and sell its own collateral trust farm loan bonds secured by a deposit of such loans with the Registrar of the district. It can, however, do no banking or *other* general business (sec. 13).

(b) No such agency or Land Bank can loan, except on the first *farm* mortgages, taken as specifically provided, nor issue nor obligate itself for outstanding farm loan bonds in excess of twenty times the amount of its capital and surplus, nor receive from any Farm Association additional mortgages when the unpaid principal upon existing mortgages, theretofore received therefrom, exceeds twenty times the amount of the Land Bank stock owned by it. No commission or charge, other than as specifically authorized (sec. 14), can be made or demanded.

(c) Every such agency or Land Bank must carry semi-annually to reserve 25 per cent of its net earnings until the reserve account shall show a credit balance equal to 20 per cent of its outstanding stock. Thereafter, it must annually carry to reserve account five per cent of its net earnings. Its reserves are to be invested in accordance with the rules of the Board (sec. 23).

(6) Land Bank Mortgage Loans.

No *farm* loan can exceed $10,000, and one cannot be made to other than a *cultivator* of the land. The loan must be obtained and used solely to (a) purchase or improve *farm* lands or provide equipment thereon, or (b) to liquidate existing indebtedness therefor. Interest shall not exceed six per cent, but the rate shall be the same as that in the last series of farm loan bonds issued by the Land Bank making the loan with not more than one per cent added. The rate actually charged

may, however, from time to time, be altered by the Board, so as to have, as far as practicable, uniform rates.

(7) Land Bank Farm Loan Bonds.

(a) Farm loan bonds in series of not less than $50,000, the amount and terms to be fixed by the Board, secured by *farm* mortgages may, upon the approval of the Board, be issued by any Land Bank (sec. 20) in specified denominations to run for specified minimum and maximum periods, subject to payment and retirement at any time after five years from date. Interest coupons, payable semi-annually, are to be attached, but the rate of interest must not exceed five per cent.

(b) The Secretary of the Treasury must prepare, and the Board approve, suitable bonds. The expense of the preparation, custody and delivery of the bonds is first paid by him out of any public moneys not otherwise appropriated. This, again, is but a temporary loan, for *reimbursement* must be effected through proportionate assessments on the different Land Banks.

(c) The bonds may be exchanged into registered bonds of any amount and re-exchanged into coupon bonds, at the option of the holder, under rules prescribed by the Board (sec. 20).

(d) On application by any Land Bank to the Board for approval of an issue of bonds, it must tender to the Registrar of the district, as collateral security, first *farm* mortgages or government bonds, not less in the aggregate than the

amount of the proposed issue. The Board, upon investigation and appraisement, may, in whole or in part, grant or reject an application to issue bonds (sec. 18).

Every agency or Land Bank which issues bonds is primarily liable for the principal and interest thereof and for the principal and interest of any such bonds issued by any *other* Land Bank. The Farm Loan Commissioner, an officer named for the purpose, must on each bond certify that it is issued under the authority of the Federal Farm Loan Act, has in form and issue the approval of the Board, is legal and regular in all respects, is issued against collateral security in a designated amount and consists of United States government bonds and first farm mortgages, and that *all* Land Banks are liable for the payment thereof (sec. 21). Any farm loan bond is a lawful investment for all fiduciary and trust funds, and may be accepted as security for all public deposits. It may be bought and sold by any bank member of the Federal Reserve System and any Federal Reserve Bank may buy and sell same to the same extent and subject to the same limitations as in the case of state, county, district and municipal bonds (sec. 27).

(e) The loans shall be amortized. All amortization or other payments on the principal of mortgages securing farm loan bonds shall constitute a trust fund in the hands of the Land Bank to be applied to (a) pay off farm loan bonds issued by it as they mature, (b) purchase at or below par its own farm loan bonds or those issued

by any other Land Bank, (c) loan on qualified first farm mortgages, or (d) purchase government bonds (sec. 22).

(8) Farm Associations.

(a) To obtain, for borrowers, exclusive services, like those ordinarily rendered by real estate commission agents or brokers, there are by the Board established borrowers' corporate agencies, known as Farm Associations. Such corporations can only be formed by those persons recommended by a Land Bank who borrow money on *farm* mortgage security. No one, other than a borrower, can hold any of the stock. Therefore, the Farm Association is owned and controlled solely by the borrowers. The corporate charter must designate the territory in which loans can be made (sec. 7). The stock bears a double liability and the shares are limited to $5 each. Every borrower must, in order to get a loan, subscribe for stock equaling in amount five per cent of his loan (sec. 8), and to get the money to pay for same, he can add the amount to his mortgage. The Farm Association, in turn, must, when applying for the loan, subscribe for a similar amount of stock in the Land Bank of the district and pay for same when the mortgage is retired. The effect is, therefore, that the borrower takes and pays for the stock of the Land Bank, which is his own agency to reach the investors.

(b) Whenever the subscription of the Farm Association to the capital stock of any Land Bank

equals $750,000, the bank must, until its original capital (that which the government *temporarily* takes) is retired at par, to that end apply to its retirement 25 per cent of all sums thereafter subscribed. Thereupon the relation of the agency or bank to the government *entirely* disappears. It then becomes absolutely the property of the borrowers.

(c) At least 25 per cent of that part of the capital of any Land Bank outstanding in the name of the Farm Associations must be held in quick assets. These may consist of deposits in member banks of the Federal Reserve System, or in readily marketable securities approved by the Board, but not less than five per cent of such capital shall be invested in government bonds (sec. 5).

(d) The Farm Association must, as the agent for the borrower, make application for and endorse and become liable for the loan and attend to all the details of making it. A loan, when made, is to be paid over to it by the Land Bank, and the Farm Association, in turn, must pay it over to the applicant.

(e) The Farm Association, as an evident aid to borrowers desiring to accumulate funds with which to make their payments, may issue certificates against deposits of current funds for not more than a year, bearing interest at not to exceed four per cent after six days. Such deposits, when received, shall be forthwith transmitted to such Land Bank, to be by it invested in Land Bank bonds or first *farm* mortgages (sec. 11).

(f) Such association can do no other and no general business (sec. 11).

(9) Land Banks may be designated as government depositaries.

(a) All Land Banks may, by the Secretary of the Treasury, be designated as depositaries of public money, excepting receipts from customs. They may also be employed as financial agents of the government. They must in these capacities perform all reasonable duties which may be required of them. These are mere incidents to, not the *main* purposes of, the scheme. The Secretary of the Treasury must require from the banks thus designated satisfactory security, by the deposit of United States bonds, or otherwise, for the faithful performance of their duties. No government funds deposited with such banks can be invested in farm mortgage loans or farm loan bonds (sec. 6). Up to the present time, no Land Bank has been designated as a depositary of public money, nor, except in the specific instances hereinafter mentioned, been employed as a financial agent of the government. No one of them has performed any duties as such depositaries, or financial agents, nor have they or any of them accepted any deposits or engaged in any banking business (Bill, Rec. 10), except that during the summer of 1918, the Land Banks at Wichita, St. Paul and Spokane were designated as financial agents of the government for the *sole* purpose of making seed grain loans to drought-stricken farmers. The President, at the request of the Secre-

tary of Agriculture, set aside, out of his $100,000,000 of war funds, $5,000,000 for that purpose. These three banks made upwards of fifteen thousand seed loans, aggregating $4,500,000, all secured by crop liens. In making these loans, the three banks acted without compensation. This, under a joint circular of the Treasury and Agricultural Departments, which allowed actual expenses, but no more (Bill, Rec. 10).

(10) Actual operations under the Act and government temporary aid authorized by and extended to Land Banks under the amendment of January 18, 1918.

(a) Organized in 1916, the Board began active operations early in 1917. It is a matter of common knowledge that American investors looked upon the whole scheme as political, sectional, speculative, or as class legislation of a vicious nature. Anyhow, they would not buy the farm loan bonds. In June, 1917, the Board, which to exist had to create a market, with the aid of a resourceful Secretary of the Treasury, made an agreement with a powerful New York banking syndicate to sell and the syndicate to buy, at par, fifty per cent of all the Land Bank bonds to be issued during the first six months, June 1, to November 30, 1917, with a provision that neither should, prior to 1918, sell any bonds to the public at less than 101⅛. The syndicate, in this indirect way, obtained from the public a commission of 1⅛ per cent for selling half of the six months issue of bonds. This was

but an expensive expedient to introduce the bonds on the market.

(b) The Land Banks were unable to sell any bonds directly to farmers having savings to invest, although this was the co-operative basis of the European acts. They were unable to sell them to ordinary investors, as promised by the congressional advocates of the Act. They were unable to sell, even with the assistance of a great American banking syndicate, more than about one-half the amount provided for in the six months syndicate contract. They were wholly unable to sell another bond after November, 1917, when that contract expired. A complete breakdown of the whole scheme was threatened. Thereupon, the ability of the resourceful Secretary of the Treasury again came to the front. The Act was, on January 18, 1918, amended so that he, upon request of the Board, could, out of any unappropriated public money, make *temporary* deposits, not in excess of $6,000,000, in and for the *temporary* use of the Land Banks. In plain words, money was at that time on hand and had been or could be easily raised from the sale of Liberty bonds. This was the money which could, in this way, be loaned to Land Banks. Any such bank receiving the deposit was required to issue a demand certificate of deposit bearing a rate of interest not exceeding the current rate charged for other government deposits and to secure same by farm loan bonds or other collateral. The Secretary was permitted, during the fiscal years of 1918 and 1919, up to $100,000,000 per year, to likewise purchase farm loan bonds from Land Banks. Any such bank

could, at any time, repurchase, on the same terms, the bonds so purchased, and should, upon demand, do so as to all such bonds as were held in the treasury when one year elapsed after the end of the war. The original *temporary* organization of any Land Bank was required to be continued so long as any bonds so *temporarily* purchased should be held in the treasury and until the stock subscriptions made by the Farm Associations should equal the amount of stock held by the government (sec. 36, as amended January 18, 1918; 40 Stat. L. 431.)

(c) Pursuant to the amendment, temporary deposits of large sums (Rec. 8) were made, for which two per cent certificates of deposit were issued. Of these there have been repaid (Rec. 8) large amounts. The Land Banks owned on September 30, 1919, $4,230,805 of United States bonds, and the Joint Stock Banks, $3,287,503 thereof. The government took stock of the Land Banks aggregating $8,892,130, and on July 1, 1919, held $8,265,809 thereof. It purchased $149,775,000 of Land Bank bonds. Of these, it held on July 1, 1919, $136,885,000. On September 30, 1919, the total issue of Land Bank bonds aggregated $285,600,000. Of these, $135,000,000 were held in the treasury under the amendment of January 18, 1918.

(11) Receivers and liquidation of Land Banks and Farm Associations.

The Board may appoint a receiver of any Land Bank or Farm Association, who, in the course of

liquidation, may sell all its property on such terms as the Board or a court of competent jurisdiction directs. But neither the association nor bank can, without the consent of the Board, go into voluntary liquidation (sec. 29).

(12) Exemption from taxation.

Each Land Bank and Farm Association, including the capital and reserve or surplus thereof and the income derived therefrom, is exempted from federal, state, municipal and local taxation, except taxes upon real estate held, purchased or taken by it. First farm mortgages executed to Land Banks and farm loan bonds issued by them are "instrumentalities of the Government," and as such, they and the income derived therefrom are exempt from all federal, state, municipal and local taxation (sec. 26).

7. ANALYSIS OF THE ACT SO FAR AS IT CONCERNS JOINT STOCK BANKS AND THE CLEAR DISTINCTION WHICH MUST BE MADE BETWEEN THEM AND THE LAND BANKS.

(a) As an evident after-thought, and to enable *large* investors to escape *all* kinds of income taxation, *some* persons, in *some* way, induced well-meaning lawmakers to provide for *other* unrestricted agencies, in addition to the Land Banks, owned and controlled by *outsiders,* to deal only with the *large* investors. These other and unre-

stricted *outside* agencies are federal corporations known as Joint Stock Banks.

(b) They, *without limit in numbers,* can, with nothing but the approval of the Board, be organized by *any* ten or more *natural* persons, regardless of their being borrowers. Neither the government, Farm Association nor Land Bank has any connection therewith, nor any interest therein, nor can either hold any of the stock. The organization is thereby, in each instance, without restrictions, made up of *outsiders* and kept in the hands of those who may happen to be favored by the Board. The sole corporate purposes are to loan, in *unlimited* amounts, on *farm* mortgage security and issue and sell collateral trust farm loan bonds secured thereby. If proper agencies, there was no necessity for Land Banks, and nine-tenths of the Act could have been omitted. Such institution must have, at least, five directors. All stock has a double liability, and the stockholder has the same voting privilege as a stockholder in a national bank. It can do no *general* banking or other business. In plain words, its *sole* business is to make farm loans without *restrictions* and to issue and sell bonds secured thereby. $250,000 of its capital must be subscribed and one-half paid up. To issue any bonds, all the capital must be paid. It is to have the same powers and be subject to the restrictions and conditions imposed on Land Banks, so far, but not otherwise, as same may be applicable, but practically every feature which led to or could justify the organization of Land Banks is declared to be inapplicable. Thus, interest rates cannot, as in the

case of Land Banks (sec. 17, subd. (b)) be reduced by the Board so as to make any equalization thereof; its loans, as required in the case of those of Land Banks (sec. 12, subds. 1, 4, 6, 7, 10), need not be secured on *farm* lands in the banking district, nor made to a *cultivator* of land, nor the proceeds thereof used for a specific farming purpose, nor the amount of each loan limited to $10,000, nor the borrower required to agree that if the whole or any portion of the loan be expended for purposes other than those specified, or if there be any other default, the whole amount shall become due. The borrower can not use part of the loan to pay for any stock in a Farm Association. The only substantial limitation is that loans can only be made if secured by *first* mortgage on any *farm* lands within the state in which the Joint Stock Bank is located, or one contiguous state. The interest to be charged cannot exceed by more than one per cent the rate established by the last series of farm loan bonds issued. Under no form or pretense can commissions be charged, nor can there be made any charges not specifically authorized. All bonds shall, however, be in a form prescribed by the Board, have added thereto the words Joint Stock, and by engraving, form and color made distinguishable from Land Bank bonds. Each shall state that the bank issuing it is organized under section 16, is under federal supervision and is operating under the Act.

(c) Such bank can be a depositary of public moneys, or may be (sec. 6) employed as a financial agent of the government. This, however, is not the *main* purpose of the agency, but rather a

mere *incident* to the *private* business done. However, no such bank has ever been (Bill, Rec. 10) either such depositary or financial agent.

(d) The provisions for the amortization of Land Bank mortgages and for the liquidation and a receivership of those institutions apply to Joint Stock Banks.

(e) All farm loan bonds are lawful investments for fiduciary and trust funds, may be used as security for public deposits, and any bank of the Federal Reserve System may buy or sell same.

(f) All farm mortgages taken and all farm loan bonds issued are "instrumentalities of the Government," and all income therefrom is exempt from all federal, state and municipal taxes.

(g) Large investors have not failed to profit by the organization of these banks. Twenty-seven of them have been organized (Bill, Rec. 9; Appendix, Part 2, *Infra*, p. 91), and up to October 31, 1919, they had paid in $7,812,050 of capital, issued $46,255,000 of farm loan bonds of which $41,000,000 are still outstanding (Bill, Rec. 11; Report 317, Senate Bill No. 3109, Calendar No. 270, 66th Congress, 2nd Session). So un-American are these institutions and so unfair to the public is the withdrawal of large investments from taxation, that the Senate Committee on Currency and Banking has favorably reported (Report 317, Appendix, Part 2, *Infra*, p. 91) a bill (Appendix, Part 3, *Infra*, p. 94) to repeal for the future all tax exemptions of the loan bonds upon the ground "that the tax exemption privilege ought never have been extended," and "the accumulation of large aggre-

gations of capital, wholly exempt from any and all forms of taxation, is wrong in principle and should be discontinued." The committee was of opinion that, "the large taxpayers will gradually absorb these bonds which will contribute nothing to the support of the government."

ASSIGNMENTS OF ERROR.

The assignments of error (Rec. 33) are that the court below erred in:

1. Decreeing a dismissal of the bill.
2. Holding to be valid and constitutional the Farm Loan Act, and also the amendment thereof, approved January 18, 1918.
3. Holding to be valid and constitutional each of the sections 21, 26 and 27 of the Farm Loan Act of July 17, 1916.
4. Holding that defendant can lawfully invest in and purchase Land Bank bonds.
5. Holding that the defendant can lawfully invest in and purchase Joint Stock Bank bonds.

QUESTIONS IN THE CASE.

The questions in the case are:

1. Whether Congress had the power to establish either Land Banks or Joint Stock Banks.

2. Whether Congress had the power to exempt from taxation the mortgages taken or the bonds issued by either of said banks.

APPELLANT'S ARGUMENT.

I.

The substance of the Farm Loan Act, as amended, which was the attempted exercise by Congress of the power now challenged.

This case involves the question of the validity of the Farm Loan Act as amended (8 Fed. Stats. Ann. Supp. 1918, pp. 14-42; 39 Stat. L. 360; 40 Stat. L. 431), and its tax exemption features (secs. 21, 26) as applied to both the Land and Joint Stock Banks.

The substance of the Act is a scheme, the *main* purpose of which is to create, for borrowers and lenders, *private* corporate borrowing and lending agencies. These agencies were not to (sec. 13) and did not actually (Bill, Rec. 10) do any *general* banking business. They were expressly forbidden so to do. Their energies were *exclusively* confined to lending on *farm* mortgages (1) $10,000 or less to actual cultivators of the soil, with which to buy or improve the land, and (2) *unlimited* sums to *any* person for *any* purpose whatsoever. In its most concrete form, the scheme created and classified the agencies into corporations *called* Farm Associations, Land Banks and Joint Stock Banks. The *alleged* banks were, however, only such in *name*. They did (Bill, Rec. 10) and could do (sec. 13) no banking business. They

are, however, of such distinct kinds that the separate nature of each must be kept distinctly in mind.

(a) Farm Associations and Land Banks.

Each of any ten or more cultivators and owners of farm lands may mortgage same for not more than $10,000, but only to buy or improve them. They must, however, *first* form a corporation, known as a Farm Association. This corporation, made up exclusively of borrowers, acts as a broker or commission agent ordinarily does, simply as a borrowers' agency. In so doing, it endorses the paper of each borrower, thus, in a way, putting all borrowers behind each loan. Each borrower subscribes and pays for his stock in a sum equalling five per cent of the loan. This sum is added to the mortgage and made part of the loan. The Farm Association must, however, apply to and obtain the money from a Land Bank, and, as a condition of so doing, must take and pay for exactly the same amount of the bank's stock. The real parties to each loan are the borrower and lender. They are, regardless of the agencies intervening, the only ones interested. One furnishes the money, the other pays it back with interest. In this the *public* has no concern, and no *governmental* function is *essential* to the scheme.

It is true that the first money to be loaned the borrowing farmers was obtained from the government. This, by it subscribing and paying for about $750,000 of each Land Bank's stock. While it was to so take the stock, it could receive no

dividends thereon. Each transaction was, therefore, practically a government temporary loan, without interest. This kind of a loan by a government relates to a *proprietary*, not a *governmental* interest. As business justifies it, the government Land Bank stock must be taken over with the money paid in by future borrowers in payment of their Farm Association stock subscriptions. The Land Bank, out of the first moneys, thus *temporarily* loaned, acquires farm loans. It then can, and is expected to, raise *new* money for *future* investment by the sale of its own collateral trust bonds secured thereby. This is the extent of its office and it is strictly a matter of *private* concern, if there is a distinction between one which is *private* and *proprietary* and one which is *governmental*.

When the Farm Association has taken up the government's *temporary* loan, held in the form of Land Bank stock, the government's interest, in a scheme supposedly permanent, absolutely ceases. The borrowers then become sole owners of the agencies and step into absolute control thereof. From that time, the government has not even a *proprietary* interest.

(b) Joint Stock Banks.

Abandoning all the reasons for the use of the Land Banks, Congress, as an apparent afterthought conceived the notion of having established Joint Stock Banks. Had these, in the first instance, been provided for, Land Banks would have been unnecessary and nine-tenths of the entire act

could have been dispensed with. The government has not the slightest connection with the Joint Stock Banks, and can never have any interest therein. Individuals, not necessarily borrowers, *only* can organize, own and control same. These *alleged* banks can loan to *any one* on farm lands, in *unlimited* amounts and without any restrictions as to the use made of the land or to be made of the money borrowed thereon. The extent of their calling is to lend on *farm* mortgages and issue and sell their own bonds with the mortgages as collateral trust security. In no sense of the term does (Bill, Rec. 10) or can (sec. 13) the agency engage in banking. So as to somewhat similar organizations it has been very generally (*Infra* Div. V, subd. [d]) and here, several times expressly held (*Selden* v. *Equitable Trust Co.*, 94 U. S. 419; *Mercantile National Bank* v. *New York*, 121 U. S. 138; *Jenkins* v. *Neff*, 186 U. S. 230). Moreover, no one of the alleged banks ever actually did any banking business (Bill, Rec. 10).

(c) Difference between the Land and Joint Stock Banks.

Not only is there a difference between the Land and the Joint Stock Banks as to the ownership and control thereof, but, in the case of the Land Banks, the loans are made to *farm* occupants in *restricted* amounts and for *specific* purposes, while with the Joint Stock Banks there are no restrictions as to amount, persons or purposes. While in this way noncultivating farmers or even speculators can borrow on vacant land and on easy terms,

the large investor really reaps the *greatest* benefit, for he, by a *private* investment of *private* funds, is permitted to go tax-free.

(d) Inducements held out to investors.

To induce investors to *continue* to furnish, after the temporary government loan, the money for the Land Bank business and *start* into that of the Joint Stock Bank, a *huge* price is paid, if tax exemption can be considered a "price," as it actually is. The securities are entirely withdrawn from the domain of the states and arbitrarily made exempt from any kind of taxation, state or federal. This by simply, but falsely, *calling* them "instrumentalities of the Government." This plain method of depriving a state of its revenue, if carried far enough, can destroy the existence of any local government. The discrimination against borrowers, not owning farms, and in favor of *large* investors and *farm owners,* is unfair and really so harsh and arbitrary as to be against the spirit of American institutions.

(e) The scheme was never intended to be governmental.

The entire scheme, as attempted to be justified, is contrary to the views of the American Commission (63d Cong. 2d Sess. Sen. Doc. 261, Part 1, p. 13), which reported:

> "It is the opinion of the Commission that our American problem of rural credit should be worked out *without government aid* * * *.

If there is not private capital in sufficient quantities, the only way the government can get the needed capital is either by *taxing all the people* in order to get capital for farming, or else by issuing bonds that sometime later must be *paid by all* the people. * * *

One of the great lessons learned in Europe is that in the long run the farmers succeed best when they help themselves. Whenever they become dependent on the government, they keep looking to the government for more aid. It is believed to be a correct general statement that rural credit is on the strongest basis in those countries, where it has been developed most completely *without government aid.*

Even granting the great importance of agriculture, *it is improper for all the people to be taxed in order to assist the prosperity of even a great class like the farming class.*

Anything in the way of national favors or opportunities for borrowing money on land would be almost certain to encourage speculation in land. This would lead to still higher prices for land and still greater difficulty in getting the land into the hands of owners who till it.

It is sometimes urged that the government should loan money directly to farmers at a very low rate of interest. * * * It is doubtful if it will help the farmers in the long run if they are given special privileges. In other words, the government should help bring about a better system of rural credit by legislation, but not by subsidy."

The United States Commission said in its report (63d Cong. 2d Sess. Sen. Doc. 380, p. 22) to Congress:

> "It is our opinion that such aid should not be extended in the United States. * * * The idea of Federal aid is always attractive and commands many able, earnest advocates; *but self-help should be the motto of our new agriculture.* If given the opportunity, under liberal enactment of law, the savings of our nation will gladly invest in this safe field and relieve the Federal Treasury of any necessity to finance the project. It is wise legislation, rather than liberal appropriations or loans which rural credit mostly needs at our hands."

President Wilson, entertaining the same view, in his first annual message (Dec. 2, 1913), said:

> "The farmers, of course, ask and should be given *no special privilege, such as extending to them the credit of the government itself.* What they need and should obtain is legislation which will make their own *abundant and substantial credit resources* available as a foundation for joint, concerted local action in their own behalf in getting the capital they must use. It is to this we should now address ourselves."

The then Secretary of the Treasury, Mr. McAdoo, said, in a speech before the Chamber of Commerce at Washington, on Feb. 4, 1915, with respect to a proposition to lend money for another private industry:

> "Gentlemen, you ask us to stand for a proposition to *lend money* to private corporations or individuals *upon the security of mortgages. Never on the face of the earth.* I

> tell you, gentlemen, if you enter upon it, you will have to lend money of the government upon railroads and every other enterprise. Bills are referred to me asking * * * raids upon the United States Treasury in the form of actual loans to be made by the Treasury of the United States on this thing and that thing, *farm loans,* loans upon houses built by working men, etc. *If we go into the money-lending business, we will have to lend it to everybody;* you cannot discriminate under our system of government. Everybody must tap the treasury till if you attempt any such resolution as this."

In 1916, both the Senate Committee on Banking and Currency and the Joint House and Senate Committee on Rural Credits made (64th Cong. 1st Sess. House Doc. 494, p. 6) this report:

> "The American farmer does not come to Congress with a hard luck story. He does not ask the government to bestow on him the public money that all the people have contributed for taxes. He does not demand that the government become a banker in order to borrow money on bonds and loan the proceeds to him. * * * He demands legislation that shall put it in the power of those who are interested and those who have money to invest to extend to him the credit he requires."

Upon these recommendations the Farm Loan Act was passed.

(f) The theory upon which is found the power to pass the Act.

By assuming the scheme to be one to do a *general* banking business, which each of such agencies is expressly prohibited (sec. 13) from doing, it is sought to justify its adoption as an exercise of an implied *governmental* power. Regardless of that which may be urged as a reason for sustaining the legislation, the real fact remains that the *main* purpose of these corporate agencies or *alleged* banks is *not* to perform any *governmental* function, as distinguished from which is strictly *private*. The *main, chief* and only *substantial* purpose is to use the system for the *private* or *proprietary* interests of borrowers and lenders. There may, for effect, or as a mere cloak, have been inserted in the Act some apparent minor *governmental* functions. These were, however to be exercised, if at all, only as an *incident* to the *main purpose*. Certain it is that these agencies (Bill, Rec. 10) were not *primarily* established or ever used for any such *incidental* purposes. Therefore, in the light of the *main* purpose of the organization, the power of Congress to establish these agencies must be determined.

II

Unless granted to Congress expressly or by fair implication from some other express power, the power to create Land and Joint Stock Banks must be deemed not to have been in Congress, but reserved to the people of the United States.

(a) The 10th Amendment to the Constitution provides:

> "Powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people."

To this plain provision effect has repeatedly been given and the rule established that the delegation of a power must be *expressly* granted or else be fairly implied from some other power which is actually expressed. The cases go no further than this (*M'Culloch* v. *Maryland*, 4 Wheat. 316; *Osborn* v. *Bank*, 9 Wheat. 738; *Kansas* v. *Colorado*, 206 U. S. 46; *First National Bank* v. *Union Trust Co.*, 244 U. S. 416).

(b) There is no *express* power to adopt the farm loan system. It therefore becomes necessary to find whether there is any power expressly given from which it can fairly be implied. The lawyers who claim that there is such an *implied* power may be divided into two schools: First, those who, as an entirely new and recent discovery, find the implication in the express power "to levy and collect taxes," and second,

those who in general loose thought, assume that *all* banks exercise *governmental* functions, to which any that are *private* and *proprietary* are mere incidents. They, so assuming, find in the express power to establish the government itself, room for an implication of the power to establish such banks as governmental agencies and therefore parts of the government. These two views, resting on entirely different grounds, demand separate consideration. Attention will therefore be first directed to the newly discovered question whether from the express power "to levy and collect taxes," there can be fairly implied the power to establish the farm loan system, a startling proposition for the support of which no authority is or can be cited, but against which *Kansas* v. *Colorado*, 206 U. S. 46, would seem to be conclusive.

III

Such express power not having been given, none can be fairly implied (Art. I, Sec. 8) from the power "to levy and collect taxes."

To find an *implied* power, some *express* power must be pointed out from which the *implication* flows as an incident. Such *express* provision is claimed to be contained in the constitutional declaration (Art. I, sec. 8, clause 1) that "Congress shall have power to levy and collect taxes * * * and provide for the common defense and general welfare of the United States." *Express* power is here clearly given to levy and col-

lect taxes. This implies the power to spend the money, at least, for a proper purpose, and one for which the collection was made. Congress has, then, *some* power to appropriate money. Having the power to so appropriate, it is plausibly suggested that an appropriation can be made for the support or encouragement of "the general welfare," and as Congress can, in some respects, legislate concerning agriculture, it has the *implied* power to appropriate money therefor. From this it has been suggested that the Act might be sustained by treating it as an appropriation of money for the public welfare. This reasoning is entirely too far fetched and refined to follow and has never been in actual experience applied. Moreover, it is in the teeth of and contrary to the principles settled by *Kansas* v. *Colorado*, 206 U. S. 46, 87, 88, 90, 91. There it was decided that there could not, from the general welfare clause, or any other provision of the Constitution, be implied any power in Congress to reclaim arid land. No mere extract could do full justice to the opinion of Mr. Justice Brewer in that case. After declaring that the United States was a government of delegated powers, he, among other things, said:

> "As heretofore stated, the constant declaration of this court from the beginning is that this government is one of enumerated powers. * * * Turning to the enumeration of the powers granted to Congress by the eighth section of the first article of the Constitution, it is enough to say that no one of them by any implication refers to the reclamation of arid lands. * * * But the proposition

that there are legislative powers affecting the nation as a whole which belong to, although not expressed in, the grant of powers, is in direct conflict with the doctrine that this is a government of enumerated powers. That this is such a government clearly appears from the Constitution, independently of the amendments, for otherwise there would be an instrument granting certain specified things made operative to grant other and distinct things. This natural construction of the original body of the Constitution is made absolutely certain by the Tenth Amendment. This amendment, which was seemingly adopted with prescience of just such contention as the present, *disclosed the widespread fear that the National Government might, under the pressure of a supposed general welfare, attempt to exercise powers which had not been granted.* With equal determination the framers intended that no such assumption should ever find justification in the organic Act, and that if in the future further powers seemed necessary they should be granted by the people in the manner they had provided for amending that Act. * * * The argument of counsel ignores the principal factor in this article, to-wit, 'the people.' Its principal purpose was not the distribution of power between the United States and the states, but a reservation to the people of all powers not granted. The preamble of the Constitution declares who framed it, 'we the people of the United States,' not the people of one state, but the people of all the states, and Article X reserves to the people of all the states the powers not delegated to the United States. The powers affecting the internal affairs of the states not granted to the

United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, and all powers of a national character which are not delegated to the national government by the Constitution are reserved to the people of the United States. The people who adopted the Constitution knew that in the nature of things they could not foresee all the questions which might arise in the future, all the circumstances which might call for the exercise of further national powers than those granted to the United States, and after making provision for an amendment to the Constitution by which any needed additional powers would be granted, they reserved to themselves all powers not so delegated. This Article X is not to be shorn of its meaning by any narrow or technical construction, but is to be considered fairly and liberally, so as to give effect to its scope and meaning. * * * This very matter of the reclamation of arid lands illustrates this: At the time of the adoption of the Constitution within the known and conceded limits of the United States there were no large tracts of arid land, and nothing which called for any further action than that which might be taken by the legislature of the state, in which any particular tract of such land was to be found, and the Constitution, therefore, makes no provision for a national control of the arid regions or their reclamation. But, as our national territory has been enlarged, we have within our borders extensive tracts of arid lands which ought to be reclaimed, and it may well be that no power is adequate for their reclamation other than that of the national government. But if no such power has been granted, none can be exercised."

The proposition could be here well rested. If, however, substantial reasoning in its support could be applied or clearly and logically followed, the entire controversy would be narrowed to the two inquiries whether (a) the Act *is* an appropriation of money, and (b) if so, whether the means adopted were, as they must be (*M'Culloch* v. *Maryland*, 4 Wheat. 316, 421; *Kansas* v. *Colorado*, 206 U. S. 46, 88; *First National Bank* v. *Union Trust Co.*, 244 U. S., 416), appropriate to the end in view.

(a) A casual reading demonstrates that the Act is not, and was never intended to be, an appropriation of money. Only *incidentally* is the public money used, and then only *temporarily* and as a means of accomplishing the real object of the legislation. In no sense is the use of public money essential, nor is it in any degree the object to be attained. The only appropriation is for the purpose of carrying into effect an act which there is supposedly power to pass. Paragraph 5 of section 5 provides that if, within thirty days after the opening of subscription books, any part of the minimum capitalization of the Land Banks remains unsubscribed, the Secretary of the Treasury shall, on behalf of the government, subscribe for the balance. Section 32, as amended, permits $6,000,000 of public money to be deposited in the Land Banks for their *temporary* use. Section 33 appropriates $100,000 to carry the act into effect. These are the only references to public money, and afford the occasions on which an appropriation, if made, could be used. Unquestionably the *sole* purpose of the Act is to establish a system of *farm*

lending. The title, misleading as it is, shows that it is not an appropriation act, but was by its framers only conceived to be one "to provide capital for agricultural development, to create standard forms of investment based upon farm mortgages, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create government depositaries and financial agents for the United States and for other purposes." These words suggest no thought of an appropriation. Complete machinery was provided for accomplishing the ends in view. It was, in the first instance, contemplated that it should all be done without the use of a dollar of public money, except the necessary expenses of organization, and even they were to be repaid. Land Banks, Joint Stock Banks and Farm Associations were to be formed without financial assistance from the government, and, with the exception of Land Banks, must be formed without its assistance. In this excepted case, it was provided that *if* the necessary stock subscriptions did not come from private sources, the government should subscribe the minimum balance, to be *repaid*, without interest or dividends, as rapidly as additional stock could be placed. The legislation is perfect and complete in all its parts without an appropriation. The latter, even if it could be implied, is simply an *incident* designed to make the Act effective if other means should *temporarily* fail. The Act can no more be justified as an appropriation of public money than could one incorporating a national insurance or other *private* company, to which was attached a section providing that the government should subscribe for any stock

not subscribed by individuals. That which the Act does is to provide *private* capital for *private* investment on *private* farm land security, the standardizing of *farm* mortgage investments and the equalizing of rates of interest on farm loans. Some public money *may* temporarily be used to put the Act into operation. The immediate purpose and intent, however, was that all the organizations should function absolutely *without public money,* and every provision was expressly and adequately framed to accomplish that end. The plain truth is that the system created is one for conducting a *farm* loan business by *national* corporations under *national* control and regulations, free from *state* interference and from *any kind of taxation,* state or federal. It would seem to be pure subterfuge to call the Act an appropriation of public money.

(b) Considered, however, as an appropriation measure, the means adopted are neither necessary nor proper to the end in view. Congress may, of course, adopt any *proper* means to accomplish a legitimate end. It can do no more (*M'Culloch* v. *Maryland,* 4 Wheat. 316, 421; *Kansas* v. *Colorado,* 206 U. S. 46, 88; *First National Bank* v. *Union Trust Co.,* 244 U. S. 416). The end to be accomplished by this legislation was not the development of agriculture or the stabilization of *farm* credits. No power to develop agriculture or stabilize farm credits can be found anywhere in the Constitution. It cannot be implied any more than could (*Kansas* v. *Colorado,* 206 U. S. 46) be the power to reclaim arid lands. The legitimate, and only legitimate, end of the legislation is the spending of public money for the *private* business and *private* ends of

a *particular class* of people. This is the end which must, if it can, justify the means. The apparent strength of any argument in favor of the implied power to pass the Act must be based upon a fundamentally erroneous deduction. It must be claimed, first, that the development of agriculture is within the general welfare clause; second, that it is, therefore, a legitimate object of congressional appropriation; third, that being a legitimate object, Congress may adopt any proper means to further it, and, fourth, that the means under consideration are proper. This is a complete *non sequitur*. It might be said that, being a legitimate object of *congressional appropriation*, any means proper to *carry into effect such appropriation*, if made, may be adopted. If any such argument were made, the conclusion would be untenable, for the means provided by the Act are not proper to the end in view. If Congress lawfully appropriated $9,000,000 for the purpose of making loans to farmers, it might have been proper to create boards and corporations to handle such *public* funds and make such loans under suitable provisions. Provision might possibly have been made for the continuous use of the money so appropriated by relending it when the original loans should be paid off. No such provisions were, however, made. On the contrary, Congress provided for the organization of *private* corporations whose capital is to be subscribed in the first instance by *private* individuals and later by other private individuals organized into Farm Associations. It provided for these *private* corporations raising additional funds by the sale to *private* individuals of bonds to be paid

for by *private funds*. It provided expressly and necessarily that even such public money as might temporarily be used to put the system on its feet should be promptly and regularly paid to the government *as fast as any business was done*. The machinery is especially arranged *not* to get public money *in*, but to keep *public* money *out* and to eliminate expeditiously any *public* money that may get in. No loan can be made by the Land Banks without a *private* subscription to its stock which leads directly to the retirement of government stock. The scheme cannot succeed without the speedy disappearance of all *public* money therefrom. It was the evident purpose that no *public* money should be used, unless absolutely necessary, but that if any such were necessary. it should be as little in amount and for as short a time as possible. The means were admirably adapted to accomplish *that* purpose. This, even more plainly, appears in the case of the Joint Stock Banks. These institutions, *privately* financed, owned and controlled, never handle a penny of government money, even *temporarily*. They might, perhaps, be a proper part of a scheme of farm credits, but they are and can be no part of any machinery for expending public money. Their real purpose is to afford the opportunity for large investors to escape the payment of just taxes, a thing for which they are always looking.

These contentions are not technical. They go to the very root of the matter. No one can read the Act without being convinced, beyond a doubt, that the appropriation was a means to carry into effect the legislation and not the legislation a

means to carry into effect the appropriation. Unless Congress can legalize, as it cannot (*Kansas* v. *Colorado*, 206 U. S. 46, 88, 89) *any* act thought by it to be beneficial by appending an appropriation to carry it into effect, then the power here attacked cannot be *implied* from the right to appropriate money. If the Congress can so act, then it can organize corporations to manufacture farming implements or to build workingmen's cottages or lawyers' homes or to reclaim arid lands or to furnish water to cities, provided only that an appropriation of public money is also involved. Doubtless such organizations would always succeed in spending the money, but that fact alone would not justify them as a proper means for the execution of the powers of Congress. The real question is: Can an appropriation, even if made, be used as a mere *pretense* to cover the exercise of an unauthorized power? The present is a striking example of the attempt. Though the *public* money now invested will shortly be returned to the government, the pretended means for spending can go on forever, functioning a complete system for doing, in the various states, a *private* farm loan business. Dealing wholly in *private* capital, with not a cent of *public* money invested (or to be invested) the banks will remain forever justified, if at all, by the thought that they *once* assisted in spending some *public* money *conditionally* appropriated for *temporary* use in *establishing the very banks in question.*

Congress has no power to create a corporation for the purpose of handling an appropriation whose term of existence is not limited to the dura-

tion of the appropriation, but whose essential functions do not come into full play until after the repayment of the public money and continue thereafter indefinitely. Congress can designate any person or corporation a depositary of public money and can make any person or corporation a fiscal agent. These provisions, *incidental* to the *main* purpose, can not alone justify the entire scheme. They are mere *incidents* to a *private* business in a *private* interest. If they justify the scheme, then Congress can create corporations to exercise powers of the widest latitude in any kind of business simply by designating them as depositaries or fiscal agents, though, as here, they were never intended to and never did act as such. These mere designations do not make the corporations appropriate for the end in view, if otherwise they would be appropriate.

IV.

The express power to establish a government implies the power to establish banks, only if their main purpose is to perform governmental functions.

There remains to be considered the view entertained by that second group or school of lawyers, who loosely and erroneously assume, that all banks exercise *governmental* functions, to which any *private* function is a mere incident. They find, from the express power to establish the government itself, room for an implication of the power to establish, as a part thereof, all gov-

ernmental agencies. They necessarily, in this instance, base this view upon their loose and erroneous assumption. Unless the agencies are *governmental,* the reason for the rule invoked ceases, and when the reason ceases, the rule of law based thereon loses its force.

(1) Reasoning upon which the proposition rests and its inapplicability here.

(a) This view rests upon the thought that, although the 10th Amendment reserved to the states all the powers not granted to the United States, yet since general banking was a *governmental* function, as distinguished from that which was *private,* Congress had, as was decided in *M'Culloch* v. *Maryland,* 4 Wheat. 316; *Osborn* v. *Bank,* 9 Wheat. 738, 792, and *Farmers' & Mechanics' National Bank* v. *Dearing,* 91 U. S. 29, known as the National Bank Cases, the implied power to establish such banks, even though coupled therewith and as an *incident* thereto, *private* functions were also to be exercised. The evident reason why all great lawyers do not rely upon so simple a proposition, is the difficulty in assuming here that the Act ever created *banks,* the *main* purpose of which was to perform *governmental* functions. With the premise gone, the proposition must fall.

(b) All the powers of a state or the United States are either governmental or else private and proprietary. These two classes of powers are well defined, quite distinct and fully recognized (*South Carolina* v. *United States,* 199 U. S. 437, 461, 462; *First National Bank* v.

Union Trust Co., 244 U. S. 416; *Illinois Trust & Savings Bank* v. *Arkansas City*, 76 Fed. Rep. 271, 282, 22 C. C. A. 171). In the South Carolina case (199 U. S. 437, 461, 463), Mr. Justice Brewer reviewed the decisions and concluded as to such powers there was a marked distinction between "those which are of a strictly *governmental* character," and "those which are used * * * in the carrying on of an ordinary *private* business." He then concluded:

> "Now, if it be well established, as these authorities say, that there is a clear distinction as respects responsibility for negligence between the powers granted to a corporation for governmental purposes and those in aid of private business, a like distinction may be recognized when we are asked to limit the full power of imposing excises granted to the national government by an implied inability to impede or embarrass a state in the discharge of its functions. It is reasonable to hold that, while the former may do nothing by taxation in any form to prevent the full discharge by the latter of its governmental functions, yet, whenever a state engages in a business which is of a private nature, that business is not withdrawn from the taxing power of the nation."

The learned justice adopted, as applicable to the government, the distinction as to the governmental and private powers of a city. Of these, in the Arkansas City case (76 Fed. Rep. 271, 282, 22 C. C. A. 171), Judge Sanborn said:

"A city has two classes of powers—the one legislative, public, governmental, in the exercise of which it is a sovereignty and governs its people; the other proprietary, *quasi* private, conferred upon it, not for the purpose of governing its people, but for the private advantage of the inhabitants of the city and of the city itself as a legal personality. In the exercise of the powers of the former class it is governed by the rule here invoked. In their exercise it is ruling its people and is bound to transmit its powers of government to its successive sets of officers unimpaired. But in the exercise of the powers of the latter class it is controlled by no such rule, because it is acting and contracting for the private benefit of itself and its inhabitants, and it may exercise the business powers conferred upon it in the same way, and in their exercise it is to be governed by the same rules that govern a private individual or corporation. Dill. Mun. Corp. (3d Ed.) Sec. 66, and cases cited in the note; *Safety Insulated Wire & Cable Co.* v. *City of Baltimore,* 13 C. C. A. 375, 377, 378, 66 Fed. 140, 143, 144; *San Francisco Gas Co.* v. *City of San Francisco,* 9 Cal. 453, 468, 469; *Com.* v. *City of Philadelphia,* 132 Pa. St. 288, 19 Atl. 136; *New Orleans Gaslight Co.* v. *City of New Orleans,* 42 La. Ann. 188, 192, 7 South. 559, 560; *Tacoma Hotel Co.* v. *Tacoma Light & Water Co.,* 3 Wash. St. 316, 325, 28 Pac. 516, 519; *Wagner* v. *City of Rock Island,* 146 Ill. 139, 154, 155, 34 N. E. 545, 548, 549; *City of Vincennes* v. *Citizens' Gaslight Co.,* 132 Ind. 114, 126, 31 N. E. 573, 577; *City of Indianapolis* v. *Indianapolis Gaslight & Coke Co.,* 66 Ind. 396, 403; *Read* v. *Atlantic City,* 49 N. J. Law, 558, 562, 9 Atl. 759. In contracting for waterworks to supply itself and

its inhabitants with water, the city is not exercising its governmental or legislative powers, but its business of proprietary powers. The purpose of such a contract is not to govern its inhabitants, but to obtain a private benefit for the city itself and its denizens. 1 Dill. Mun. Corp., Sec. 27; *City of Cincinnati* v. *Cameron*, 33 Ohio St., 336, 367; *Safety Insulated Wire & Cable Co.* v. *City of Baltimore, supra* and cases cited under it."

In *Bank of United States* v. *Planters Bank*, 9 Wheat. 904, 907, 908, Mr. Chief Justice Marshall outlined the same view by saying:

"* * * when a government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates, and to the business which is to be transacted. * * * As a member of a corporation, a government never exercises its sovereignty. It acts merely as a corporator, and exercises no other power in the management of the affairs of the corporation than are expressly given by the incorporating Act.

The Government of the Union held shares in the Old Bank of the United States; but the privileges of the government were not imparted by that circumstance to the bank. * * * The government, by becoming a corporator, lays down its sovereignty, so far as respects the transactions of the corpora-

tion, and exercises no power or privilege which is not derived from the charter."

It is, therefore, manifest that the Act, as an exercise of an implied power, cannot stand if the agencies organized to carry it out, whatever called, did not, in the *main*, exercise *governmental* functions, and not those strictly of a *private* character. There cannot be ignored the difference between and "the scope and character of * * * *governmental* and *private* powers." The latter cannot be treated as a wholly immaterial consideration. So all thinkers are taught by the doctrine of *South Carolina* v. *United States*, 199 U. S. 437, and *First National Bank* v. *Union Bank & Trust Co.*, 244 U. S. 416. Congress could not, as it attempted, provide for a farm loan system by giving the *name* of banks to simple loan agencies, and calling them, regardless of their actual character, "instrumentalities of government." Otherwise, form could override substance.

V.

No implied power existed to pass the Act because the main function of the agencies appointed was to deal with and for private and proprietary interests.

(a) The question.

Here arises the trouble in the case, for if the *agencies* established were not, in fact, *general* banks, or, regardless of what they were, if their *main* purpose was *not* to exercise *governmental*

functions, to which *private* business was a mere incident, the premise on which the proposition rests wholly fails. *South Carolina* v. *United States*, 199 U. S. 437, and *First National Bank* v. *Union Trust Company*, 244 U. S. 416, when properly applied, are conclusive authorities in support of this view.

(b) The fact that the agencies provided were actually named banks, does not prevent an inquiry into the unquestionable fact that they were not in reality such.

This because mere words or forms cannot be used to evade a plain constitutional mandate. The calling of a corporation a bank, when, in fact, it is not such, cannot justify the exercise of a power forbidden by the constitution. This is what Mr. Justice Harlan had in mind when he, in *Western Union Telegraph Co.* v. *Kansas*, 216 U. S. 1, 27, said:

> "This court has repeatedly adjudged that in all such matters the judiciary will not regard mere forms, but will look through forms to the substance of things. Such is an established rule of constitutional construction, as the adjudged cases abundantly show. • • • In *Mugler* v. *Kansas*, 123 U. S. 623, it was said the courts, when determining whether a statute is consistent with the fundamental law, must not deem themselves 'bound by mere forms, nor are they to be misled by mere pretenses. They are at liberty—indeed, are under a solemn duty—to look at the substance of things, whenever they enter upon the inquiry whether the legislature has transcended the limits of its authority.'"

In the same case, Mr. Justice Holmes said (l. c. 55):

> "I hardly can suppose that the provision is made any the worse by giving a bad reason for it or by calling it by a bad name. I quite agree that we must look through form to substance."

Here the agencies provided for, though so-called, were not banks at all. The *main* purpose thereof was to do business of a *private* and *proprietary* character. The *governmental* functions, if any, were only *incidental* to that *main* purpose.

(c) The National Bank Cases teach no different doctrine.

The claim of an implied power must, therefore, to find any support in the early National Bank Cases, rest on the fact that the Act really established *general* banks, as it does not, the *main* functions of which were *governmental*, and the *private* business to be done was only an *incident* thereto. If the main functions of the agencies established were simply to perform *private* and *proprietary* acts, as distinguished from those which were *governmental*, and the latter were merely *incidental* to the others, then no implied power existed.

That the National Bank Cases rested upon the sole theory stated is plain. Banks, the power to establish which is implied, within the meaning of the rule of these cases, must be *real* banks which perform real and substantial *governmental* functions. This must be, not a mere incident to, but

the *main* object of their existence. The exercise of *private* powers must come solely as an incident (*First National Bank* v. *Union Trust Co.*, 244 U. S. 416) to the *main* purpose. As it is with other *incidents* to interstate commerce, there must be "a real or substantial connection with" the *main* public function (Second Employers' Liability Cases, 223 U. S. 1).

If the National Bank Cases so rest, then they clearly do not constitute authority for the proposition that there was any implied power to pass the Act, unless its *main* purpose was to provide agencies to perform functions which were *governmental*. This is apparent from the slightest review of the opinions therein.

Thus, in *M'Culloch* v. *Maryland*, 4 Wheat. 316, it was said:

> "A bank, to the Government, 'is a convenient, a useful and *essential* instrument in the prosecution of *its* fiscal operations.'"

In *Osborn* v. *Bank*, 9 Wheat. 738, 860, 861, 863:

> "The bank is not considered as a private corporation, whose *principal* object is individual trade, and individual profit, but as a *public* corporation, created for *public* and *national* purposes. That the mere business of banking is, in its own nature, a private business, and may be carried on by individuals or companies having no political connection with the government, is admitted; but the bank is not such an individual or company. It was not created for its *own* sake, or for *private* purposes. *It has never been supposed that Con-*

gress could create such a corporation. • • • Why is it that Congress can incorporate or create a bank? • • • It is an instrument which is *'necessary* and proper' for carrying on the *fiscal operations of government.* Can this instrument, on any rational calculation, effect its object, unless it be endowed with that faculty of lending and dealing in money which is conferred by its charter? If it can, if it be as competent to the purposes of government without as with this faculty, there will be much difficulty in sustaining that essential part of the charter. If it cannot, then this faculty is *necessary* to the *legitimate operations of government,* and was constitutionally and rightfully engrafted on the institution. • • • The operations of the bank are believed not only to yield the compensation for its services to the government, but to be *essential* to the performance of those services. Those operations give its value to the currency in which all the transactions of the government are conducted. They are therefore inseparably connected with those transactions. They enable the bank to render those services to the nation for which it was created, and are therefore of the very essence of its character, as national instruments. The business of the bank constitutes its capacity to perform its functions *as a machine for the money transactions of the government.* Its corporate character is merely an *incident* which enables it to transact that business more beneficially."

In *Farmers' & Mechanics' Bank* v. *Dearing,* 91 U. S. 29:

> "The national banks organized under the act are instruments designed to be used *to aid the government* in the administration of an important branch of the *public* service."

(d) The banks which come within the rule of the National Bank Cases are well known and clearly defined instrumentalities.

Banks are not unknown things. They are capable of being and have frequently been defined. The very definition, so far as concerns the exercise of a *governmental* function, is well understood. They are not such agencies as the act contemplates and creates.

In 3 Encyclopedia of United States Supreme Court Reports, pp. 5-7, the cases from this court are gathered and from them it is concluded:

> "A bank is a *quasi-public* institution. Banks, in the commercial sense, are of three kinds, to-wit: 1, Of deposit; 2, of discount; 3, of circulation. All or any two of these functions may, and frequently are, exercised by the same association, but there are still banks of deposit, without authority to make discounts or issue a circulating medium. * * * A banker is one who has a place of business where deposits are received and paid out on checks, and where money is loaned upon security. The business of banking, as defined by law and custom, consists in the issue of notes payable on demand, intended to circulate as money where the banks are banks of issue; in receiving deposits payable on demand; in discounting commercial paper; making loans of money on collateral security; buying and selling bills of exchange; negotiating loans,

and dealing in negotiable securities issued by the government, state and national, and municipal and other corporations."

In footnote 2, page 6, it is said:

"Strictly speaking, the term bank implies a place for the deposit of money, as that is the most obvious purpose of such an institution. Originally, the business of banking consisted only in receiving deposits, such as bullion, plate and the like, for safekeeping until the depositor should see fit to draw it out for use, but the business, in the progress of events, was extended, and bankers assumed to discount bills and notes and to loan money upon mortgage, pawn or other security, and at a still later period to issue notes of their own intended as a circulating currency and a medium of exchange instead of gold and silver."

These definitions are fully sustained by the cases (*Bank for Savings* v. *Collector,* 3 Wall. 495, 512; *Oulton* v. *Savings Institution,* 17 Wall. 109; *Warren* v. *Shook,* 91 U. S. 704; *Selden* v. *Equitable Trust Co.,* 94 U. S. 419; *Knickerbocker Life Ins. Co.* v. *Pendleton,* 115 U. S. 344; *Mercantile National Bank* v. *New York,* 121 U. S. 138, 156; *Guthrie* v. *Harkness,* 199 U. S. 148, 157). So, whenever there is any kind of congressional power to establish banks, the plain meaning is that those established must be institutions, the *main* purpose of which is to exercise *governmental* functions.

(e) Agencies like Land and Joint Stock Banks are, therefore, not banks within the meaning of the principle.

Coming still closer to this case, it may be said that agencies like Land and Joint Stock Banks, prohibited from doing a banking business, are not banks, the *main* purpose of which is to exercise *governmental* functions, for, as has been (*State* v. *Reid,* 125 Mo. 43, 52) well said, "the mere fact that a corporation is authorized to exercise *some* of the functions of a bank does not, in law and in fact, create it a bank within the meaning of * * * law."

In 3 Encyclopedia of the United States Supreme Court Reports, pp. 5-7, it is stated:

> "And trust companies are not banks in the commercial sense of the word * * * . The business of the stock broker is ordinarily distinct from the business of a banker, or according to the common understanding, is not a banker."

In *Selden* v. *Equitable Trust Co.,* 94 U. S. 419, 423, a corporation which, exactly as the Land and Joint Stock Banks do, loaned its own money on notes secured by mortgages and sold these securities with its guaranty, using the proceeds to make other loans, was held not to be a "bank," Mr. Justice Strong pointedly saying:

> "The Equitable Trust Company lent its own money, taking bonds and mortgages therefor. Those bonds it sold with a guaranty. It sold only its own property, not that re-

> ceived from other owners for sale. Such a business, in our opinion, did not constitute the corporation a banker, as defined by the revenue laws."

In *Mercantile National Bank* v. *New York,* 121 U. S. 138, 159, Mr. Justice Matthews aptly put it:

> "Trust companies * * * are not, *in any proper sense* of the word, banking institutions, * * * are not banks in the commercial sense of that word and do not perform the functions of banks in carrying on the exchanges of commerce."

This doctrine was restated and applied in *Jenkins* v. *Neff,* 186 U. S. 230. In *Wells Fargo & Co.* v. *Railroad* 23 Fed. 469, an express company did far more of the ordinary business done by a bank than can be done by a Land or Joint Stock Bank, yet it was, upon unanswerable reasoning, held not to be a bank. So, in a somewhat similar case, it was said as to a savings association (*State* v. *Louisiana Savings Co.,* 12 La. Ann. 568). Substantially, the same rulings (*Loan & Trust Co.* v. *Helmer,* 77 N. Y. 64; *Pratt* v. *Short,* 79 N. Y. 437; *People* v. *Railroad,* 12 Mich. 390; *State* v. *Granville Alexandrian Society,* 11 Ohio 1; *State* v. *Stebbins,* 1 Stewart (Ala.) 299; *State* v. *Reid,* 125 Mo. 43; *State ex inf.* v. *Lincoln Trust Co.,* 144 Mo. 562), have been applied to many other like corporations. Probably the best detailed and most extended review of the cases is found in *State* v. *Reid,* 125 Mo. 43, a careful reading of which will probably satisfy any inquiring mind

that neither a Land nor a Joint Stock Bank is, in any sense, a bank, the *main* purpose of which is to perform some *governmental* function, and to which any *private* power exercised is a mere *incident* (*Osborn* v. *Bank*, 9 Wheat. 738; *First National Bank* v. *Union Trust Co.*, 244 U. S. 416). Such an agency has not "any real or substantial connection" (Second Employers' Liability Cases, 223 U. S. 1) with the exercise of any *governmental* function. Instead of the *private* powers being an *incident* to those which are *governmental*, the few minor governmental powers are unreal, unsubstantial and merely *incidental* to the exercise of those which are strictly *private* and *proprietary*.

VI.

The designation of the banks or agencies as government depositaries and financial agents is not the main purpose of the scheme, but, at most, was a mere incident thereto.

(a) Section 6 of the act provides:

> "That all Federal Land Banks and Joint Stock Land Banks organized under this act, when designated for that purpose by the Secretary of the Treasury, shall be depositaries of public money, except receipts from customs, under such regulations as may be prescribed by said Secretary; and they may also be employed as financial agents of the Government; and they shall perform all such reasonable duties, as depositaries of public money and financial agents of the Government, as may be required of them. And the Secretary of the

Treasury shall require of the Federal Land Banks and Joint Stock Land Banks thus designated satisfactory security, by the deposit of United States bonds or otherwise, for the safekeeping and prompt payment of the public money deposited with them, and for the faithful performance of their duties as financial agents of the Government. No Government funds deposited under the provisions of this section shall be invested in mortgage loans or farm loan bonds."

This section permits the banks to be designated as depositaries of public money and their employment as financial agents of the government. They must, in such capacities, perform only such reasonable duties as may be required of them. They must, by the deposit of United States bonds, or otherwise, give security for the faithful performance of their duties. All government funds in any such depositary or financial agency must be kept separate and apart from any other funds and cannot be invested in farm mortgages or bonds.

(b) It is wholly immaterial that some artful mind may have suggested the insertion of this section to give to the scheme a mere color that *governmental* functions were to be performed. It is sufficient to say they were not the main purpose of the scheme. If anything, they were mere *incidents* to the *main* purpose. That main purpose was to obtain from *private* persons *private* money to loan for the *private* use of one class and the *private* gain of another.

(c) This view accords with the practical workings of the Act. The bill (Rec. 10) avers that

none of the *alleged banks*, Land or Joint Stock, has ever engaged in the banking business. It also avers that neither has been made a government depositary or financial agent, nor ever accepted any government deposits, except that during the summer of 1918, the Land Banks at Wichita, St. Paul and Spokane were designated as financial agents of the government for the *sole* purpose of making seed grain loans to drought-stricken farmers. The President, at the request of the Secretary of Agriculture, set aside, out of his $100,000,000 of *war* funds $5,000,000 for that purpose. These three banks made upwards of fifteen thousand seed loans, aggregating $4,500,000, all secured by crop liens. In making these loans, the three banks acted without compensation. This, under a joint circular of the Treasury and Agricultural Departments, which allowed actual expenses but no more (Bill, Rec. 10).

VII.

Exemption from Taxation.

(a) Under section 21, each Land Bank farm bond must recite "that it is not taxable by national, state or municipal authority." Section 26 specifically exempts Land Banks and Farm Associations from practically *all* taxation. It also exempts *all* Land Bank and Joint Stock Bank *farm* loan mortgages and bonds, and the income therefrom, declaring them to be "instrumentalities of the government." The validity of these provisions is separately challenged.

(b) If, of course, the act is unconstitutional as to either class of banks, no tax exemption can, as to that bank, be upheld, because as Mr. Justice Field in *Norton* v. *Shelby County*, 118 U. S. 425, said:

> "* * * an unconstitutional act is not a law, it confers no rights, it imposes no duties, it affords no protection, it creates no office; it is in legal contemplation as inoperative as though it has never been passed."

(c) While *real* governmental instrumentalities are exempt or can be exempted from state taxation (Willoughby on Constitution, sec. 45, *et seq.*), the exemption should never be lightly extended (*Thomson* v. *Union Pacific R. Co.*, 9 Wall. 579). This because Congress cannot call something such an instrumentality and by such a simple method relieve it from state taxation. Otherwise, little by little, encroachments could be made until there was nothing left for a state to tax, and the state itself would fall for lack of revenue to support it. There must, therefore, be an *actual* governmental instrumentality before, without more, it is or can by Congress be made exempt from any state tax. So, whatsoever Congress may do as to exempting property from a tax levied under its own authority, it cannot grant an exemption from a state tax unless the latter be levied upon that which is really an instrumentality of the government.

(d) Whether such loans or bonds are or can be made *governmental* instrumentalities, depends upon whether the *main* purpose of the agency is-

suing them is to exercise a *governmental* function, or one that pertains to *private* or *proprietary* interests. So it has been distinctly held (*First National Bank* v. *Union Trust Co.*, 244 U. S. 416; *South Carolina* v. *United States*, 199 U. S. 437). Hence, in the end, this may be concluded: If the *main* purpose of either agency is to exercise a governmental function, to which the exercise of *private* powers is a mere incident, a federal tax exemption exists as to that particular agency. It is otherwise, if the *main* purpose is to exercise a *private* function, to which the *governmental* powers are mere *incidents*.

VIII.

Even if the Act and its tax exemption feature can be upheld as to the Land Banks, they cannot be sustained as to the Joint Stock Banks.

(a) As an evident after-thought and to enable *large* investors to escape *all* kinds of income taxation, *some* persons by *some* inconceivable method, convinced Congress that it should, as it did (sec. 16), provide for *other* unrestricted *moneymaking* agencies, in *addition* to the Land Banks, owned and controlled by *outsiders*, to deal only with the *large* investors.

These other and unrestricted *outside* agencies are federal corporations known as Joint Stock Banks.

(b) They, *without limit in numbers*, can, with nothing but the approval of the Board, be organ-

ized by *any* ten or more *natural* persons, regardless of their being borrowers. Neither the government, Farm Association nor Land Bank has any connection therewith nor any interest therein, nor can either hold any of their stock. The organization is thereby in each instance, without restrictions, made up of *outsiders* and kept in the hands of those who happen to be *favored* by the Board. The sole corporate purposes are to loan, in *unlimited* amounts, on *farm* mortgage security and issue collateral trust farm loan bonds secured thereby. Such an institution must have, at least, five directors. All stock has a double liability, and the stockholder has the same voting privilege as a stockholder in a national bank. It can do no *general* banking or other business and h' (Bill, Rec. 10) never done any. Its *sole* business is to loan on *farm* mortgages and issue and sell bonds secured thereby. $250,000 of its capital must be subscribed and one-half thereof paid up. To issue any bonds, all the capital must be paid. It has the same powers and is subject to the restrictions and conditions imposed on Land Banks, so far, but not otherwise, as same may be applicable, but practically every feature which led to or could justify the organization of Land Banks is declared to be inapplicable. Thus, interest rates cannot, as in the case of Land Banks (sec. 17, subd. [b]) be reduced by the Board so as to make any equalization thereof; its loans, as required in the case of those of Land Banks (sec. 12, subds. 1, 4, 6, 7, 10), need not be secured on *farm* lands in the banking district, nor made to *cultivators* of land, nor the proceeds

thereof used to buy or improve the farms, nor the amount of each loan limited to $10,000, nor the borrowers required to agree that if the whole or any portion of the loan be expended for purposes other than those specified, or if there be any other default, the whole amount shall become due. The borrowers can not, as in the case of the Land Banks, use part of the loan to pay for any stock in a Farm Association. The only substantial limitation is that the loans shall be made if secured by *first* mortgage on *farm* lands within the state in which the Joint Stock Bank is located or one contiguous. Presumably, as a source of *private* profit to this outside agency, the interest charged on a mortgage loan can exceed by one per cent the rate established by the last series of farm loan bonds issued. All bonds, while in a form prescribed by the Board, must have added thereto the words, Joint Stock, and by engraving, form and color be made distinguishable from Land Bank bonds. Hence, a decision herein that a Joint Stock bond was invalid, would not, of itself, affect one issued by a Land Bank.

(c) Such agency, like a Land Bank, can be a depositary of public moneys, or may be (sec. 6) employed as a financial agent of the government. This, however, is not the *main* purpose of the Act, but rather a mere *incident* to the *private* business done for the *private* interest. However, it has never acted as a bank, received current deposits or in any wise acted either as a government depositary or financial agent (Bill, Rec. 10).

(d) The provisions for the amortization of Land Bank mortgages and for the liquidation and

a receivership of those institutions apply to Joint Stock Banks.

(e) As if Congress had not done enough for the outsiders' profit-making machine and the large investors' tax exemption haven, all Joint Stock farm loan bonds are made lawful investments for fiduciary and trust funds, they are permitted to be used as security for public deposits and may be bought and sold by any bank of the Federal Reserve System.

(f) All farm mortgages taken and all farm loan bonds issued are in *name* declared to be "instrumentalities of the Government," and all income therefrom actually exempted from all federal, state and municipal taxes.

(g) Large investors have not failed to profit by the organization of these banks. Twenty-seven of them have been organized (Bill, Rec. 9), and up to October 31, 1919, they had paid in $7,812,050 of capital, issued $46,255,000 of farm loan bonds of which $41,000,000 are still outstanding (Bill, Rec. 11; Report 317, Senate Bill No. 3109, Calendar No. 270, 66th Congress, 2nd Session). So un-American are these institutions and so unfair to the public is the withdrawal by *large* investors of *large* investments from taxation that the Senate Committee on Currency and Banking has favorably reported (Report 317, Appendix, Part 2; *Infra*, p. 91) a bill (Appendix, Part 3; *Infra*, p. 94) to repeal, *for the future*, all tax exemptions of the loan bonds because "the tax exemption privilege ought never to have been extended," and "the accumulation of large aggregations of capital, wholly exempt from any and

all forms of taxation, is wrong in principle and should be discontinued." The committee was of the clear opinion that "the *large* taxpayers will gradually absorb these bonds, which will contribute *nothing* to the support of the government."

In a very recent strong article in his own magazine (41 Farm & Home, No. 849, p. 6, January, 1920) headed "A National Scandal," Herbert Myrick, the reputed "Father of the Federal Farm Loan Act," concluded:

> "The weak spot can be found, even in the best of things. The federal farm loan system is no exception. The nigger in the wood pile stands revealed. *It is in the section which authorizes Joint Stock Land Banks.* * * * 'Why, the thing is a national scandal,' truly remarked Senator Knute Nelson of Minnesota in a recent conversation. The Senator spoke wisely."

(h) Abandoning all the reasons for the use of the Land Banks, Congress, as an apparent afterthought, conceived the notion of having established Joint Stock Banks. Had these, in the first instance, been provided for, Land Banks would have been unnecessary, and nine-tenths of the entire Act could have been dispensed with. The government has not the slightest connection with the Joint Stock Banks, and can never have any interest therein. Individuals, not necessarily borrowers, *only* can organize, own and control same. These *alleged* banks can loan to *any one* on farm lands, in *unlimited* amounts and without *any* restrictions as to the use made of the land or to be made of

the money borrowed thereon. The extent of their calling is to loan on *farm* mortgages and issue and sell their own bonds with the mortgages as security.

Not only is there a difference between the Land and the Joint Stock Banks as to the ownership and control thereof, but, in the case of the Land Banks, the loans are made to *farm* occupants in *restricted* amounts and for *specific* purposes, while with the Joint Stock Banks there are no restrictions as to amount, persons or purposes. While in this way non-cultivating farmers, or even speculators, can borrow on vacant land and on easy terms, the large investor really reaps the greatest benefit, for he, by a private investment of private funds, is permitted to go tax-free. In the practical working out of the scheme, still more pointed and detailed distinctions have been observed. The *alleged* advantages to *large* investors of *tax-free* Joint Stock Bank bonds have, *pending the litigation*, been made the subject of such advertisements as should shame even eager and keen-minded selling brokers. All this has been a subject for congressional attention, the details of which appear in a government printed document of November 13, 1919, entitled "Amendment to Federal Farm Loan Act. Hearings before the Committee of Banking and Currency of the House of Representatives on H. R. 8159, a bill to amend the Act of Congress, approved July 17, 1916, known as the Federal Farm Loan Act, to increase the limit of loans."

(i) So, even if any reason can be found to sustain the Act or the tax exemption therein as to the

Land Banks, there is no fair reason for so doing as to Joint Stock Banks.

The lower court (Rec. 27-29) really so recognized by saying:

> "Now as to the Joint Stock Land Banks and their Farm Loan bonds, of course, I think all those present will admit that there is a possible line of cleavage between the two. That is to say, it would appear, almost, that you could take some sharp instrument and cut the Joint Stock Land Banks out of the Act, and that the Federal Land Banks and their bonds would function just the same. That is, there is no absolute connection, in so far as the system, as a system, is concerned, between the two, but it has been pointed out that these banks are to serve a different class of customers, those who require larger loans; that they have a distinct function to perform, along the same line as the Federal Land Banks.
>
> They are incorporated into the same Act. We cannot leave out of mind that one great system is here being created, comprehensive in its nature, containing many parts, and all so interwoven and interrelated that each performs its appointed part in the development and administration of the entire system.
>
> It may be said—perhaps the Supreme Court may say—that they are so far separated from, and not so necessarily connected with the system that they may be taken out, taken apart, and dealt with separately, but certain it is that they are thoroughly germane to the system, and certain it is that they have been dealt with in one comprehensive, systematic plan.
>
> That being so, it does not seem to me, when I take into consideration the fact, also, that they have been, even though arbitrarily, cre-

ated depositaries of the government, created as financial agents of the government, that the arguments against them are so clear and convincing as they must be to warrant a court of first instance to overcome the presumption of constitutionality which must prevail, and to declare these Acts unconstitutional, even as to the Joint Stock Land Banks.

I am aware that in a certain very conspicuous instance, the court, in the interest of expedition, has deemed it wise to indulge the presumption of unconstitutionality in the first instance, instead of constitutionality. That is something that I cannot bring my mind to accept, and when these banks are thus designated as banks—as depositaries, and as financial agents, why, if the use is conceded in any degree, this court cannot consider the degree of their usefulness in that regard.

It stands there as the deliberate judgment of Congress that they are such, they are adapted to the use—even though their powers may have to be enlarged to make them most useful, they are adapted to the use that Congress has assigned them. That being so, all things considered, and there being no question here, nor can be in this court, as to the wisdom and practicability of this system, then in the absence of any complete unadaptability, the court must accept their status as declared.

But whatever might be my view on these Joint Stock Banks, certainly the matter must go to the Supreme Court.

Upon one branch of the question, as I say, I am unreservedly without doubt. Upon the other, I may say, also, that I have very little, if any, doubt, although I concede that there is a more debatable question there presented,

but certainly there ought not to be a division of the questions here involved.

There ought not to be any action taken which would halt a great public enterprise, certainly, as has been pointed out, to the very great disadvantage of its operation, and of the interests of parties who are dealing with it, but the whole question should be passed upon finally, as speedily as possible, and with the least inconvenience to anyone concerned, by the Supreme Court * * *."

But, after so saying, the Act was below upheld as to the Joint Stock, as well as the Land Banks. That this was possible seems inconceivable.

Respectfully submitted,

WM. MARSHALL BULLITT,
FRANK HAGERMAN,
Solicitors for Appellant.

APPENDIX.

Part 1—Judge Thayer's Opinion.

In the Circuit Court of the United States for the Western Division of the Western District of Missouri.

W. W. Bierce et al., Complainants,

vs.

No. 2483.
In Equity.

The Guardian Trust Company, Defendant.

Mr. Frank Hagerman, Mr. L. C. Krauthoff and Mr. Max Pam for the complainants.

Mr. J. E. McKeighan, Mr. J. McD. Trimble and Mr. T. L. Chadbourne, Jr., appeared for the defendant.

Memorandum on Motion to Appoint a Receiver.

Thayer, Circuit Judge.

The subject-matter now before the court is a motion which was made on the filing of the complaint to appoint a receiver for the Guardian Trust Company, a Missouri corporation. The bill on which the application is based makes a great variety of allegations and is very voluminous. The affidavits and accompanying exhibits that have been filed by the respective parties either to support or overthrow the allegations of the complaint are also very numerous and lengthy. Owing to this fact and the complicated character of some of

the transactions that have been investigated, and the limited time at the disposal of the court—it will only be possible to state in a very general way for the information of counsel the conclusions that have been reached on the strength of which the accompanying order is based.

1. The bill of complaint as viewed by the court for the purpose of the present motion is a bill filed by minority stockholders to correct abuses of administration and to obtain the appointment of a receiver because of the mismanagement of the company's affairs and various *ultra vires* acts heretofore committed by the directors and managers who were in active control of the corporation. These acts, it is claimed, in substance, have led to a dissipation of the Company's assets and brought it to the verge of insolvency. The bill also charges, in substance, that acts of a similar nature are now in contemplation and will be committed in the future by those who are at present in control of the company if such action is not stayed by judicial process. Counsel will understand that the order made herein is not based upon the theory that the bill is one filed by the complainants to cancel and rescind their stock subscriptions on the ground of fraud, or upon the theory that the complainants are in a position at this time to maintain such a bill, although no decisive opinion need be expressed upon that point. Neither is the order herein based upon the theory that between November 4, 1899, and January 4, 1900, a valid resolution was adopted or that an agreement was entered into to go into liquidation, which resolution or agreement had the effect of impressing all the as-

sets of the Company with a trust of that date which may now be administered by a court of equity at the instance of the complainants. Counsel will understand that the court rejects for the present each of said theories and does not predicate its action thereon.

In passing, however, it may be said that such action as was taken by the Executive Committee of the Company or its Board of Directors, or other persons interested in the Company, at meetings or interviews between the dates last aforesaid, is of importance, in that it throws much light on the actual condition of the Company at that time and at the present moment. After reading all the affidavits and the records of the Company relative to what transpired at said meetings or interviews between the dates aforesaid, the court concludes that it was the unanimous opinion of all persons then connected with the Company who were conversant with its affairs that it was in a precarious condition; that practically all of its capital had been invested in stocks, bonds and notes and in real property which were not readily marketable; that many of its stocks, bonds and notes were worthless; that the value of the residue of its securities, as well as the value of much of its real property, was uncertain; that no considerable portion of its assets could be speedily reduced to money for lack of a market value, and that the Company was no longer in a condition to engage actively in the prosecution of the business which it had been organized to transact. In view of this condition of affairs existing at that time, the court concludes that it was impliedly understood and

agreed by the persons then in control of the Company, with possibly one or two exceptions, that further active operations should be suspended, at least for the time being; that the Executive Committee and Board of Directors should thenceforth endeavor to reduce the corporate assets to cash and with the proceeds liquidate the Company's debts so far as the proceeds would extend and that they should not for the present accept new business or embark in any new ventures. The court is satisfied that this policy was in fact pursued in accordance with the implied understanding aforesaid until some time in May, 1900, or for at least four or five months.

2. The real grievance disclosed by the bill and affidavits consists in the fact that the defendant Company during a period of years has persistently committed acts which must be regarded as in excess of its corporate powers, and by so doing has not only sustained grievous losses but has lost control of its capital having been compelled to pledge or hypothecate the bulk of its available assets as security for loans, so that it is not at the present time in a condition to be dealt with safely, or to transact the business which its charter authorizes it to transact, with a reasonable prospect of success.

The proof shows with reasonable certainty that the officers and directors of the defendant Company have made a practice of organizing other corporations to engage in various enterprises of a highly speculative character; that funds of the Company to a large amount have been invested in the stocks and bonds of such concerns, which had

at the time no market value; that money in considerable sums had been loaned to such companies, sometimes upon their stock as collateral, and on other occasions without any security; that some of these enterprises have been proved absolute failures, and that the money invested therein has been wholly lost, while other of such enterprises are in a precarious condition and the outcome thereof is doubtful and uncertain. The fact that officers, directors and employees of the Trust Company have generally served as officers and directors of such subsidiary companies and have held stock therein leads the court to conclude that the moneys of the Trust Company would not have been used to purchase the stock and bonds of such concerns and to supply them with capital except on the theory that they were mere adjuncts of the Trust Company and that the enterprises which it thus attempted to foster by the means aforesaid were its own adventures.

Moreover, in some cases, if not in all, there appears to have been such identity in the *personnel* of the governing bodies of these corporations and the governing body of the Trust Company that it is impossible to believe that the interests of either were fairly considered or properly guarded in any of the transactions and dealings which occurred between them.

In addition to the acts aforesaid the proof shows that the defendant Company has made large investments in real property apparently without a shadow of authority under its charter. Some of these investments may have been, and probably were, profitable, but other investments of that kind

will doubtless occasion a loss, and in any event such unauthorized investments have resulted in locking up much of the Company's available means and have impaired its usefulness.

Furthermore, the court entertains no doubt that the defendant Company has paid one, and probably several, dividends out of its general funds that were not earned, such payments being made for the purpose of allaying suspicion as to the condition of the Company and creating a false impression that it was in a prosperous condition.

Under the Missouri statute relating to trust companies the primary function of a trust company, as the name implies, is to execute trusts of all kinds and descriptions according to the rules which govern ordinary trustees, and to act as agent for the management, conservation and control of property, real or personal, which may at any time be committed to its custody, whether the owner be a natural or artificial person. When properly conducted such companies perform important and necessary functions in the business work which cannot as well be performed either by private individuals or co-partnerships. They have authority to receive money in trust from their customers and to accumulate it by loaning the same upon real estate or good collateral security. They also have power to issue debentures, provided they are secured by a pledge of mortgages or other securities which the company owns. But it was never intended that a trust company should go into the market as a borrower of money in large sums on its own notes to be employed in speculative ventures, as the defendant Company appears to have

done. The law contemplates that the business of such companies shall consist in loaning its own money or that of its customers on safe securities —not that it shall consist in borrowing money on its own notes in aid of doubtful enterprises, thereby imperiling its own solvency and disabling it from serving the public faithfully in its capacity as a trustee. In so far as such companies are authorized to buy and sell stocks, bonds and other negotiable securities the power is limited by fair intendment by the language of the Act to transactions in "investment securities," which term must be understood to mean such securities as persons of ordinary prudence and capacity would purchase for the purpose of investment. Securities of the latter kind would ordinarily be those whose value can be ascertained with reasonable certainty and is not wholly dependent upon contingencies. It is doubtless true that when acting in the capacity of agent for another and pursuant to his instructions, a trust company can buy or sell for such other persons any kind of stocks or other negotiable securities as the customer may direct, but when making an investment of its own funds, or funds held in trust, or committed to it for accumulation and investment in its discretion, the law by necessary inference places restrictions upon the class of securities that may be bought or taken in pledge as collateral. As at present advised, the court is of opinion that the Act creating trust companies does not authorize the acquisition of securities by such companies either as an investment or as collateral for loans, unless they have an ascertainable market value and may be properly termed "investment se-

curities." If the value of a stock is purely hypothetical and speculative a trust company should not acquire it for either of the purposes last indicated. Owing to the functions which trust companies are intended to perform the public has a vital interest in their solvency and in confining them strictly to the transaction of such business as the Act authorizes. It was never intended that such companies should engage in the business of promoting hazardous and highly speculative enterprises, either by the acquisition of large blocks of stocks or bonds, or by loaning large sums of money, to companies or corporations engaged in such enterprises. It is well known that by so doing a trust company speedily becomes the real power behind such enterprises and oftentimes finds that its own solvency depends upon the success or failure of subsidiary companies in whose securities it has made large and improvident investments. Several notable examples might be cited in this circuit where a line of policy such as has apparently been pursued by the defendant Company has led to widespread disaster and great public distress and inconvenience.

In accordance with these views the court is constrained to conclude that the bill and affidavits disclose many *ultra vires* acts committed by the defendant Company during the past five years; and that these acts have not only led to the dissipation of its assets and to its present embarrassment, but have rendered it unsafe for the Company to continue the further transaction of its customary business until it has realized upon some of its assets and liquidated its present indebtedness.

3. With reference to the two suggestions made on the argument of the motion that the bill of complaint does not set out specifically the commission of any such *ultra vires* acts as are heretofore mentioned, and if it does, that they are past transactions of the Company of which the complainants were duly advised before they became stockholders, and for that reason cannot be heard at this time to complain, the court entertains the following views: First: That the *ultra vires* acts referred to above are generally alleged in the fourth and fifth paragraphs of the bill and are made sufficiently specific by the affidavits now on file which have been produced both by the defendant Company and by the complainants. But if this position is not tenable, in view of the present status of the litigation and the time already devoted to it and to an investigation of the Company's affairs, the court would deem it its duty to permit any defect in the existing allegations of the bill to be remedied by amendment; and, second, as respects the suggestion that the complainants bought their stock with knowledge of the past acts of the Company and are not entitled to complain, the court entertains the view that while the complainants did know of the character of many of the Trust Company's investments, yet they were doubtless mistaken as to their value, and the court is unable to say that the complainants were acquainted with all of the facts and circumstances which rendered the investments unauthorized and wrongful. It is not deemed probable, and is not proven, that the complainants had such knowledge in detail of all the precedent acts of the Company, at the time they purchased

its stock, as should now preclude them from making complaint or exercising the ordinary rights of shareholders. They were not themselves concerned in any of the unauthorized acts of the Company which are now called in question and most likely bought without investigating the transactions in detail.

4. For the reasons thus briefly outlined the court has reached the conclusion that it is its duty under the law, for the adequate protection of all interests, to place the assets of the Trust Company in the custody of a competent receiver until a final decree shall be rendered, or until some arrangement shall be made among the shareholders which will enable the Company to resume its business with adequate capital and conduct it on proper lines. Pending the receivership stockholders will be allowed to convene and elect directors and the receiver will be instructed, in the management and disposition of the assets of the Company, to conform to such requests preferred by the directors in meeting duly assembled as commend themselves to his judgment as being steps proper to be taken in the interest of creditors and the majority of the shareholders.

Part 2—Report of Senate Committee on the Proposed Repealing Act.

CALENDAR No. 270.

66th Congress 2d Session. SENATE. Report No. 317.

FEDERAL FARM LOAN ACT.

December 8, 1919.—Ordered to be printed.

Mr. McLean, from the Committee on Banking and Currency, submitted the following

REPORT.

[To accompany S. 3109.]

The Committee on Banking and Currency, to whom was referred the bill (S. 3109) to amend section 26 of the act approved July 17, 1916, known as the Federal farm loan act, having considered the same, report favorably thereon with the recommendation that the bill do pass without amendment.

This bill removes the tax exemption from the bonds issued by the joint-stock land banks. It is the opinion of your committee that the tax-exemption privilege should never have been extended to the bonds. The accumulation of large aggregations of capital, wholly exempt from any and all forms of taxation, is wrong in principle and should be discontinued. The large taxpayers will gradually absorb these bonds which will contribute nothing to the support of the Government.

Four of these joint-stock land banks were chartered in 1917; 6 in 1918; and 20 in 1919, up to the

31st of October. The bonds already outstanding total $46,255,000. The excess earnings of some of these banks indicate that they are making large profits, and it has been represented to your committee that they are likely to encroach upon the legitimate field now occupied by the farm-loan banks unless their activities are restricted.

The Secretary of the Treasury, in a communication to your committee, expresses the opinion that exemptions from taxation should be withdrawn from future issues of bonds of these banks.

A portion of a statement furnished your committee by the Federal Farm Loan Commission, showing the number and condition of the joint-stock land banks up to October 31, 1919, is printed below:

Statement showing number and condition of joint-stock land banks.

Joint-stock land banks.	Capital stock paid in.	Amount of farm loan bonds issued.	Excess earnings to date
1. Iowa, Sioux City, Iowa	$ 250,000	$1,225,000	$56,910.77
2. Virginian, Charleston, W. Va.	250,000	2,600,000	26,560.38
3. Fletcher, Indianapolis, Ind.	300,000	3,280,000	.....
4. First, Chicago, Ill.	1,250,000	14,500,000	77,865.84
5. Liberty, Salina, Kans.	425,000	6,350,000	35,076.98
6. Mississippi, Memphis, Tenn.	250,000	700,000	5,800.91
7. Arkansas, Memphis, Tenn.	250,000	600,000	4,106.01
8. Lincoln, Lincoln, Nebr.	539,100	7,100,000	.....
9. Bankers, Milwaukee, Wis.	250,000	2,100,000	4,063.08
10. First, Fort Wayne, Ind.	250,000	500,000	4,332.21
11. First, Minneapolis, Minn.	250,000	1,300,000	1,162.13
12. Illinois, Monticello, Ill.	250,000	1,550,000	15,638.17
13. Montana, Helena, Mont.	250,000	500,000	.....
14. Fremont, Fremont, Nebr.	316,500	500,000	.....
15. Des Moines, Des Moines, Iowa.	250,000	1,000,000	5,473.02
16. First Texas, Houston, Tex.	250,000	1,000,000	126.93
17. Peters, Omaha, Nebr.	300,000	500,000	2,198.01
18. Colonian, Norfolk, Va.	125,000	.....	.....
19. Central Iowa, Des Moines, Iowa.	250,000	250,000	.....
20. Virginia-Carolina, Norfolk, Va.	125,000	.....	.....

21. Southern Minnesota, Redwood Falls, Minn.....	250,000	700,000	461.91
22. Dallas, Dallas, Tex.....	239,500	.....	.....
23. Union, Richmond, Va.....	184,450	.....	.....
24. Guarantee, Wichita, Kans.	232,500	.....	.....
25. San Antonio, San Antonio, Tex.	250,000	.....	.....
26. California, San Francisco, Calif.	125,000	.....	198.24
27. Lafayette, Lafayette, Ind..	150,000	.....	.....
Total.	7,812,050	46,255,000	239,974.59
Less.	.....	.....	99,933.94
Net excess earnings....	.....	.....	140,040.65

Part 3—Bill to Repeal Tax Exemption of Joint Stock Banks.

CALENDAR NO. 270.

66th Congress, 2d Session. S. 3109.

[Report No. 317.]

IN THE SENATE OF THE UNITED STATES.

September 30, 1919.

Mr. Smoot introduced the following bill, which was read twice and referred to the Committee on Banking and Currency.

December 8, 1919.

Reported by Mr. McLean, without amendment.

A BILL

To amend section 26 of the Act approved July 17, 1916, known as the Federal Farm Loan Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 26 of the Act of Congress approved July 17, 1916, known as the Federal Farm Loan Act, be amended to read as follows:

"SEC. 26. That every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section 11 and section 13 of this Act. First mort-

gages executed to Federal land banks and farm loan bonds issued by Federal land banks, under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal and local taxation.

"Shares in any joint stock land bank may be included in the valuation of the personal property of the owner or holder of such shares in assessing taxes imposed by authority of the State within which the bank is located, and such assessment and taxation shall be in manner and subject to conditions and limitations contained in section 5219 of the Revised Statutes with reference to the shares of national banking associations.

"This amendment shall not apply to any farm loan bond issued by any joint stock land bank prior to the taking effect of this Act. Such bonds and the income derived therefrom shall continue to be exempt from Federal, State, municipal and local taxation.

"Nothing herein shall be construed to exempt the real property of Federal land banks and national farm loan associations from either State, county, or municipal taxes, to the same extent, according to its value, as other real property is taxed."